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California Court of Appeal Limits Mandatory Inclusionary Housing Rule

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Introduction

On July 22, 2009, the California Court of Appeal ruled that a provision of a City of Los Angeles (the "City") specific plan requiring the inclusion of affordable units in certain new for-rent projects is unenforceable because such a rental restriction is preempted by the Costa-Hawkins Act (Cal. Civ. Code §§ 1954.50 *et seq*.).

Specifically, the Appellate Court in *Palmer/Sixth Street Properties v. City of Los Angeles*, 2009 WL 2170673 (Cal. App. 2 Dist.), held that provisions in the Central City West Specific Plan (the "Plan") restricting rents are preempted by the Costa-Hawkins Act. However, the Appellate Court ruling will not be final for 30 days and may be modified if a petition for rehearing is granted by the Appellate Court. Moreover, the Appellate Court's ruling will be vacated if a Petition for Review is granted by the California Supreme Court, which could subsequently reverse or revise the Appellate Court's ruling. However, if the Appellate Court's decision is not substantively reversed or revised, that decision may have far-reaching effects. The Court of Appeal's decision may ultimately affect not just for-rent projects in the area of the Plan, but also for-rent projects throughout California completed after February 1, 1995, in areas in which the project is required by municipal law to provide affordable units without an agreement granting the developer direct financial contribution or any other form of assistance.

The Appellate Court's Ruling

In the *Palmer* case, the Plan required that the developer either provide 60 affordable units or pay an in lieu fee based upon the number of required affordable units. The developer argued that under the Costa-Hawkins Act, the City is preempted from requiring that affordable rental units be provided

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by the developer. In addition, the developer asserted that in lieu fees, which the developer could have provided as an alternative, violate the Mitigation Fee Act's (Cal. Gov't Code §§ 66000.5 *et seq*.) requirement that there be a "reasonable relationship" between a fee and a development.

The Appellate Court held that the Plan's mandate that the City set rental rates for a portion of a developer's new units is invalid because it conflicts with the Costa-Hawkins Act's requirement that after February 1995 "an owner of residential real property may establish the initial rental rate" (Cal. Civ. Code § 1954.53). The Appellate Court held that "[f]orcing the [developer] to provide affordable housing units at regulated rents . . . is clearly hostile to the right afforded by the Costa-Hawkins Act to establish the initial rental rate for a dwelling unit" (*Palmer* at *9). However, "the Costa-Hawkins Act does not apply when '[t]he owner has otherwise agreed by contract with a public entity [to build affordable housing] in consideration for a direct financial contribution or any other form of assistance . . . .'" (*Palmer* at *8, quoting Cal. Civ. Code § 1954.53(a)(2)). Consequently, the precedent set by the Appellate Court appears to prohibit municipalities from regulating the rent of affordable units in instances in which a public entity has not entered into an agreement with a developer providing the developer with a direct financial contribution or other assistance. On the other hand, because the Appellate Court's ruling is based on the Costa-Hawkins Act's restrictions on rent control, the ruling does not apparently affect the ability of municipalities to restrict the sales price of for-sale units.

The City argued that the Plan's "in lieu fee provision does not conflict with the Costa-Hawkins Act, which does not mention impact fees" (*Palmer* at *9). The Appellate Court determined that because the in lieu "fee amount is based solely on the number of affordable housing units that a developer must provide under the Plan, the Plan's affordable housing requirements and in lieu fee option are inextricably intertwined" (*Palmer* at *9). Therefore, the in lieu fee option could not be considered separately from the requirement to provide affordable housing (*Palmer* at *10). Consequently, the Appellate Court did not rule on the validity under the Costa-Hawkins Act of a municipal ordinance that requires only in lieu fees, nor did it consider the validity of the Plan's in lieu fee provisions under the Mitigation Fee Act. Therefore, it is possible that a municipal ordinance may be enforceable if it does not have a restricted rent component but requires in lieu fees that conform to the Mitigation Fee Act's requirements of a nexus between each of the amount, the use and the need for in lieu fees and the impact created by the proposed development.

Conclusion

If the Appellate Court's decision is not modified at a rehearing or reversed by the California Supreme Court, the ruling provides precedent that appears

to prohibit municipalities from regulating the rent of new affordable units unless the municipality has entered into an agreement with a developer, pursuant to which such municipality provides the developer with a direct financial contribution or any other form of assistance. In other words, voluntary, opt-in inclusionary housing programs (such as the ones provided under ordinances implementing Cal. Gov't Code § 65915, commonly known as SB 1818) under which developers receive a direct financial contribution or any other form of assistance for providing rental units at controlled rental rates are acceptable. However, mandatory inclusionary housing programs under which developers are forced to provide rental units at controlled rental rates – and are not provided any financial contribution or other assistance from the government – are unacceptable.

The Appellate Court's ruling may affect rental projects that are contemplated, entitled, constructed, or even occupied. Going forward, developers may use the Appellate Court's decision to resist a municipality's attempt to require the inclusion of affordable rental units at the time that entitlements are sought. Additionally, if a rental housing project's entitlements were conditioned on the provision of affordable housing or an in lieu fee that is inextricably intertwined with an affordable housing component, a developer may be able to assert that the municipality's requirements are preempted by the Costa-Hawkins Act if the developer did not receive a direct financial contribution or other assistance. Finally, it may be that in cases in which affordable rental units have already been occupied, a developer that was required to provide such housing without having received a direct financial contribution or other assistance, could use the Costa-Hawkins Act to raise the rent of the occupied affordable units.

Although the Appellate Court's ruling is potentially far-reaching, it is not without apparent limits. First, because the Appellate Court's ruling is based on the Costa-Hawkins Act's restrictions on rent control, the ruling does not apparently affect the ability of municipalities to restrict the sales price of for-sale units. Second, the ruling did not consider the validity of in lieu fees that are not inextricably intertwined with an inclusionary housing provision. Thus, it is possible that an ordinance that did not have a restricted rent component, but which required in lieu fees, may be enforceable. Finally, the Appellate Court's ruling was based on the legal precept that the City's Plan was preempted by the state's Costa-Hawkins Act, because state laws preempt local ordinances that conflict, duplicate or enter an area fully occupied by state law (*Palmer* at *5). However, preemption does not apply when state statutes appear to conflict. Under general rules of statutory construction, unless one state statute clearly repeals, or is otherwise inimical to, another state statute, a court must reconcile the statutes without nullifying either statute and in a way that gives effect to the legislative intent (CJS Statutes § 354). Therefore, the Appellate Court's ruling has no specific impact on the state's Mello Act's (Cal. Gov't Code §§ 65590 and 65590.1) requirements for inclusionary housing in coastal zones because

both the Mello Act and the Costa-Hawkins Act are state statutes, which must be reconciled where possible. However, if a municipality had an ordinance implementing the Mello Act and that ordinance exceeded the provisions of the Mello Act, the Appellate Court's ruling might impact those portions of the implementing ordinance that exceed the Mello Act's provisions. Moreover, it is possible that a future case could establish that a conflict exists between portions of the Mello Act and the Costa-Hawkins Act, affecting the validity of the Mello Act's affordable housing requirements with regard to for-rent projects completed after February 1, 1995.

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