



California Supreme Court Holds Mitigation Fee Act Applies to Inclusionary Housing

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Yesterday, the California Supreme Court decided one of two pending cases dealing with inclusionary housing, holding that when a public agency requires a developer to convey units at below market rates and make substantial cash payments, the developer may challenge these conditions under the California Mitigation Fee Act. (*Sterling Park v. City of Palo Alto* (Oct. 17, 2013) 2013 Cal. Lexis 8112.) The California Supreme Court's decision not only clarifies the scope of the Mitigation Fee Act, an issue that has been a cause of consternation for numerous practitioners and developers, but it also provides some insight as to how the Court may resolve the other inclusionary housing case currently awaiting argument before the Court.

In *Sterling Park v. City of Palo Alto*, as a condition of approving a 96 unit condominium development, the City required the developer to set aside 10 condominium units as below-market-rate housing and make a substantial in-lieu cash payment to a City fund. The City imposed these requirements under a provision in the City's Municipal Code, which states that "[d]evelopers of projects with five or more units must comply with the requirements set forth in Program H-36 of the City of Palo Alto Comprehensive Plan." Program H-36 requires that certain housing projects set aside a percentage of the units for below-market-rate housing. Program H-36 also permits a developer to provide off site units or vacant land if it is not feasible to provide on site units, and permits the City to accept an in-lieu fee in the amount of 10 percent of the greater of the actual sales price or fair market price of each unit. In order to implement the inclusionary housing requirement, the City takes an option to purchase the below-market-rate units for the specified below-market-rate price.

On June 19, 2006, a representative for the developer executed a letter agreeing to the City's terms, and the City approved the project. The parties subsequently executed an agreement incorporating the conditions, and the City approved a tentative subdivision map and a final subdivision map. In 2009, as the construction was nearing completion, the City requested that the developer convey the 10 units designated for below-market-rate housing. The developer responded by sending a letter asserting that the prior agreements were signed under duress, and that the conditions were invalid.

In October 2009, the developer filed an action seeking to enjoin the City from enforcing the conditions, and a declaration that the inclusionary housing requirements were invalid under the Mitigation Fee Act. The City moved for summary judgment on statute of limitations grounds, arguing that the developer's action was barred by the

Subdivision Map Act, because the developer was challenging conditions imposed in connection with a decision on a tentative map or final map, and therefore the action had to be filed and served within 90 days of the date of the City's approval of the tentative or final map. (See Gov. Code, § 66499.37.) The trial court granted the City's motion and the court of appeal affirmed. Both the trial court and the court of appeal heavily relied on *Trinity Park, L.P. v. City of Sunnyvale* (2011) 193 Cal.App.4th 1014, which held that the statute of limitations in the Subdivision Map Act (Gov. Code, § 66499.37) applied to a challenge to the City's inclusionary housing requirement.

The California Supreme Court explained that while the language in the Subdivision Map Act is certainly broad enough to apply in this case, the question is whether the Mitigation Fee Act, which deals expressly with challenging the "imposition of any fees, dedications, reservations, or other exactions imposed on a development project," controls. The Court found, applying the rule of statutory construction that a specific statute controls over a general statute, that in this case if the Mitigation Fee Act applied it would control over the Subdivision Map Act. As such, the Court turned to the question of whether the Mitigation Fee Act applied.

This question required the Court to determine whether the requirements at issue are "any fees dedications, reservations, or other exactions imposed on a development project." (Gov. Code, § 66000.) In *Trinity Park, L.P. v. City of Sunnyvale*, the court of appeal held that in order for "any fee . . . or other exactions" to be subject to the Mitigation Fee Act, the fee or exaction must be imposed "for the purpose of defraying all or a portion of the cost of public facilities related to the development project." (*Trinity Park, L.P. v. City of Sunnyvale*, supra, 193 Cal.App.4th at p. 1035-1036.) The California Supreme Court held that the *Trinity Park* court erred in interpreting the terms so narrowly. The Court stated "*Trinity Park's* interpretation would mean [the Mitigation Fee Act] does not apply to fees imposed for purposes entirely unrelated to the project. Under that interpretation, if a fee or other exaction is not merely excessive but truly arbitrary, the developer would either have to pay it with no recourse, or delay the entire development to challenge the fee or exaction. In other words, the more unreasonable the fee or exaction, the less recourse the developer would have."

After expressly noting its disapproval of *Trinity Park*, the Court stated that the term "other exactions" should be interpreted broadly, holding that it "at least includes actions that divest the developer of money or a possessory interest in property, but it does not include land use restrictions." The Court also briefly expounded on what it meant by "land use restrictions," stating that the Mitigation Fee Act would not apply to restrictions on the number of units a project can contain, or how large each unit can be, "or the validity of other use restrictions a local entity might impose."

Addressing Program H-36, the Court rejected the City's argument that the Program was merely a land use restriction. The Court found that the imposition of the in-lieu fee is "certainly similar to a fee," and therefore an exaction subject to the provisions of the Mitigation Fee Act. The Court also found that the requirement that a developer give the City a purchase option is an exaction under the Mitigation Fee Act. Notably, however, the Court declined to decide whether requiring a developer to sell some units below market value was subject to the Mitigation Fee Act. The Court stated that it did not need to reach this decision, because in this case the City had required the developer to convey to the City the below-market-rate designated homes.

As is often the case with California Supreme Court decisions, while the Court resolved one controversy, there were a number of issues that still required further briefing and resolution. For example, the Court declined to decide whether the developer complied with the protest procedure and filing requirements in the Mitigation Fee Act. Accordingly, the court reversed and remanded the matter for further proceedings.

The California Supreme Court's decision provides some significant relief to developers, as it allows them to continue with a development, and thereby avoid the often substantial expenses associated with delaying a large project, while maintaining their right to challenge in-lieu fees – and potentially all inclusionary housing conditions. While the Court expressly declined to hold that requiring a developer to sell some units below market value is subject to the Mitigation Fee Act, the logic employed by the Court implies that it would likely answer this question in the affirmative.

The Court's decision in *Sterling Park v. City of Palo Alto* may indicate how the Court will resolve the issues in *California Building Industry Association v. City of San Jose*, a case which is currently pending before the Court and

awaiting oral argument. In *California Building Industry Association v. City of San Jose*, the Court is set to address whether the essential nexus and rough proportionality test set forth by the U.S. Supreme Court in *Nollan v. California Coastal Commission* (1987) 483 U.S. 825 and *Dolan v. City of Tigard* (1994) 512 U.S. 374, which are incorporated into the Mitigation Fee Act, apply to general regulations such as affordable housing ordinances. In that case, the trial court applied the nexus/rough proportionality requirements to invalidate the ordinance. The court of appeal reversed, holding that the inclusionary housing ordinance was subject only to rational basis review. In light of the U.S. Supreme Court's decision in *Koontz v. St. Johns River Water Management District* (2013) 570 U.S. ___, and the California Supreme Court's decision in *Sterling Park v. City of Palo Alto*, the California Supreme Court appears primed for another decision that will make it easier for developers to challenge inclusionary housing requirements.