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May 9, 2019

REPORT TO THE RULES COMMITTEE

LEGAL BASIS FOR ADOPTING A ZONING ORDINANCE REQUIRING ON-SITE INCLUSIONARY AFFORDABLE HOUSING

INTRODUCTION

On May 15, 2019, the Rules Committee will consider an ordinance amending San Diego Municipal Code (SDMC) provisions that require residential developments to include on-site inclusionary affordable housing. Currently, the City is exploring options to address housing affordability, including amending its existing inclusionary affordable housing laws, which require certain development to either include 10 percent of the units as affordable for-sale housing on-site or to pay an in-lieu fee.[1] SDMC §§ 142.1301 – 142.1311. Several Councilmembers have asked about the legal parameters within which the City of San Diego (City) may amend current laws.

This Report summarizes two more recent developments regarding the City's ability to require residential developments to include affordable housing: a California Supreme Court decision and an Assembly Bill. These recent developments establish a legal basis for the City of San Diego to adopt a zoning ordinance requiring on-site inclusionary affordable housing. However, any such zoning ordinance should include alternatives to the requirement to provide the affordable housing on-site, for example, providing the affordable housing off-site or paying an in-lieu fee.

ANALYSIS

I. THE CITY LEGALLY MAY ADOPT A ZONING ORDINANCE REQUIRING ON-SITE INCLUSIONARY AFFORDABLE HOUSING IF THE ORDINANCE HAS A REASONABLE RELATIONSHIP TO THE GENERAL PUBLIC WELFARE AND COMPLIES WITH CONSTITUTIONAL LIMITS

The California Supreme Court held that residential development can be required to provide on-site affordable housing in *California Building Industry Association v. City of San Jose*, 61 Cal. 4th 435 (2015). The Court held that San Jose's on-site affordable housing requirement was a zoning ordinance enacted pursuant to the municipality's police power to

[1] Under certain circumstances, residential development that provides at least 10 percent of the total units as affordable rental housing is exempt. San Diego Municipal Code (Municipal Code or SDMC) § 142.1303(f), (g).

regulate for the general health, safety, and welfare. As such, the ordinance only needed to bear a reasonable relationship to the general public welfare to be valid, and did not constitute an unconstitutional "taking" of property. *Id.*

A. Background of the City of San Jose's Inclusionary Ordinance

In 2010, faced with the realization that about 60 percent of its new housing would need to be affordable in order to meet its share of the regional need, the City of San Jose adopted an ordinance amending its municipal code to require on-site inclusionary housing in new residential development that created 20 or more new, additional, or modified dwelling units. San Jose Municipal Code (SJMC) § 5.02.250. The requirements applied when the dwelling units were produced through the creation or alteration of structures, the conversion of a use to residential from any other use, or the conversion to for-sale residential from any rental residential use. SJMC § 5.08.010. A.2. For-sale residential development and rental residential development had different inclusionary requirements. SJMC § 5.08.400 A.

For-sale residential development proposing 20 or more units was required to make 15 percent of those units available as affordable to households earning no more than 110 percent of the area median income, but could be sold to those earning no more than 120 percent of the area median income. SJMC § 5.08.400 A.1. Rental residential development was required to make 9 percent of the units available for rent to moderate income households and 6 percent available for rent to very low-income households. SJMC § 5.08.400 A.2. The ordinance provided that the rental residential development provision would be "operative at such time as current appellate case law in Palmer/Sixth Street Properties, L.P. v. City of Los Angeles, 175 Cal. App. 4th 1396 (2nd Dist. 2009), is overturned, disapproved, or depublished by a court of competent jurisdiction or modified by the state legislature to authorize control of rents of inclusionary units." *Id.*

The on-site affordable units were required to be of the same exterior quality and comparable square footage and bedroom count as the market rate units, were required to be dispersed "so as not to create a geographic concentration of inclusionary units within the residential development," and were required to have "functionally equivalent" parking as that provided to the market rate units. SJMC § 5.08.470. Differences in unit types and interior finishes, features, and amenities were permissible. *Id.*

Additionally, as originally enacted, the ordinance provided that a development that included on-site affordable units could receive economically beneficial incentives including a density bonus, a reduction in parking space and setback requirements, and could request "financial subsidies and assistance from the city in the sale of the affordable units." San Jose Ordinance 28689 (Jan. 12, 2010).[2] *Cal. Bldg. Indus. Ass'n*, 61 Cal. 4th at 451.

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[2] In 2018, San Jose Municipal Code section 5.08.450 was amended by striking the reference to financial subsidies and assistance and replacing that with a reference to density bonus, waivers, or incentives pursuant to California Government Code section 65915, *et seq*. and San Jose Municipal Code Chapter 20.190.

As an alternative to the provision of on-site affordable units, a developer could choose from the following means of compliance:

- constructing affordable units off-site;
- paying an in-lieu fee based on the median sales price of a housing unit affordable to a moderate income family;
- dedicating land in equal value to the applicable in-lieu fee;
- utilizing credits created by the construction of surplus affordable units in other developments;
- acquiring and rehabilitating a comparable number of inclusionary units that are affordable to low or very low income households; or
- any combination of these alternative options, so long as the combined methods provided substantially the same or greater level of affordability and amount of housing as would be required otherwise.

SJMC §§ 5.08.510 - 5.08.570.

The ordinance contained specific criteria to be met for each of these alternatives. *Id*. In addition, if a developer chose an alternative means of compliance for for-sale housing, the requirement increased to either 20 percent of the total units in the development, instead of 15 percent for on-site, or compliance with the requirements for off-site rental inclusionary housing. SJMC 5.08.500 A. If the developer chose an alternative means of compliance for rental housing, the requirement increased to no less than 12 percent for lower-income households and no less than 8 percent for very low income households, instead of 9 percent for moderate income households and 6 percent for very low-income households for on-site. SJMC § 5.08.500 B.

The ordinance also required that restrictions be placed on any affordable units to ensure continued affordability and to allow the city to recapture at any resale a share of the appreciation of the unit. SJMC § 5.08.600.

The ordinance allowed for a waiver, adjustment, or reduction of its requirements if an applicant demonstrated, based on substantial evidence, that there was no reasonable relationship between the impact of the development and the requirements of the ordinance, or that application of the ordinance would constitute a governmental taking of private property without just compensation, in violation of the U.S. or California Constitutions.[3] SJMC § 5.08.720. The applicant would bear the burden of presenting substantial evidence in support of a factual and legal basis for the claim, and the waiver would only be granted to the extent necessary to avoid an unconstitutional result, after adoption of written findings, supported by substantial evidence. *Id*. Lastly, in consideration of the 2008 nationwide recession, the ordinance phased-in compliance. SJMC § 5.08.300.

[3] The City's Inclusionary Affordable Housing Regulations also allow the City to grant a variance, waiver, adjustment, or reduction in the inclusionary requirements upon a finding that there is no reasonable relationship between the impacts of the development and the requirements. SDMC § 142.1308(b).

B. California Supreme Court Decision Regarding the City of San Jose's Inclusionary Housing Ordinance

1. The Inclusionary Housing Requirement Is Not An Unconstitutional Taking

The California Building Industry Association (CBIA) challenged the City of San Jose's for-sale inclusionary housing requirements, claiming that the ordinance violated the U.S. and California Constitutions' prohibitions against governmental taking of private property without just compensation.[4] These provisions prohibit the government from taking private property without due process and just compensation. U.S. Const. Amend. V, Cal. Const. art. 1, § 19. Ordinances regulating the use of private property may result in a determination that the private property has been taken in violation of these constitutional prohibitions, depending on whether the regulation is so onerous as to be equivalent to a physical taking; the extent to which the regulation interferes with a distinct, investment-backed expectation; and the character of the government action. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

The California Supreme Court upheld the City of San Jose's ordinance. First, it found that the ordinance was enacted pursuant to the City of San Jose's police powers to regulate for the general public health, safety, and welfare, and as such, only needed to bear a reasonable relationship to the general public welfare. *Id.* at 456-57. The ordinance was a legislatively imposed land use regulation, similar to other zoning ordinances such as those that regulate lot size, set-backs requirements, and permissible uses in various zones. The use of a city's police power is presumed to be constitutional so long as it is reasonably related to the general public welfare. *Id.* at 455-56. The party challenging the legislative act usually bears the burden of demonstrating that the item lacks a reasonable relationship to the general public welfare. *Id.* The Court found that the City of San Jose's objectives of complying with the California Government Code Housing Element requirements by meeting its share of regional housing needs and of locating such housing in an economically diverse development project were "unquestionably constitutionally permissible purposes." *Id.* at 462-63.

Second, the Court found that the ordinance did not effect a governmental taking of private property without just compensation. In order to have a taking within the meaning of the federal and state constitutions, there must be a governmental requirement that a property interest be conveyed. *Id.* at 460. In this case, the Court determined that the ordinance did not require property owners to dedicate any property to the public or to pay any money to the public, and so the government had not in fact received any property. *Id.* at 461. The ordinance was only a restriction on the use of property, like other land use regulations. *Id*. Additionally, a land use regulation generally cannot constitute an unlawful taking, so long as the property owner is not deprived of all viable economic use of the property, which was not the result of this ordinance. *Id.* at 462. Price controls, such as rent control, imposed by municipalities that result in a reduction in property value or a decrease in profits does not constitute an unconstitutional taking, although such measures are subject to constitutional limits and therefore may not deny a property

[4] The opinion is silent regarding the affordable rental requirements; this provision may not have been challenged because it was held in abeyance by the terms of the ordinance.

owner the fair and reasonable return on his or her property. *Id*. at 463-64. The Court noted that in this case, a property owner may not even be able to demonstrate a decrease in profit because of the numerous economic incentives offered. *Id.* at 466.

Lastly, the Court found that because the requirement for on-site affordable housing was constitutional, the allowances for alternate compliance were also constitutional. *Id.* at 468-69.

2. The Inclusionary Housing Requirement Is Not Subject to a Reasonable Relationship Standard Under the Mitigation Fee Act

The Court also rejected the CBIA's argument that the inclusionary requirements were exactions subject to a reasonable relationship standard pursuant to the Mitigation Fee Act, California Government Code sections 66000 - 66025. The Mitigation Fee Act allows the imposition of fees in connection with the approval of a development project for the purposes of defraying all or a portion of the cost of public facilities related to the development project. Cal. Gov't Code § 66001(b). The Mitigation Fee Act requires the government to determine that there is a reasonable relationship between the fee and the cost of the public facility. *Id*. The Court again noted that the purpose of the City of San Jose's Ordinance was the protection of the general public health, safety, and welfare, and therefore the affordable housing requirements were not imposed for the purpose of mitigating the impacts of residential development.

The Court found no merit to the argument that an earlier decision, *San Remo Hotel L.P. v. City & County of San Francisco*, 27 Cal. 4th 643 (2002), required the City of San Jose's inclusionary requirements to be subject to the reasonable relationship standard. *Cal. Bldg. Indus. Ass'n*, 61 Cal. 4th at 477. In *San Remo Hotel*, a requirement to either replace long-term rental units or to pay an in-lieu fee was found to be subject to the Mitigation Fee Act, because that requirement was specifically intended to mitigate the impacts of converting long-term rental units into tourist units. *Id.* at 473. The Court noted that the *San Remo Hotel* decision was specifically about fees as defined in the Mitigation Fee Act. *Id.* at 472-73. The Mitigation Fee Act defines a fee as a monetary exaction charged for the purposes of defraying some or all of the costs of public facilities related to the specific development project, and does not "encompass use restrictions, and certainly not use restrictions that are imposed for a different purpose."[5] *Id.* at 472. The City of San Jose's ordinance went beyond mitigating the impacts that proposed development may have, and was intended to address the constitutionally permissible purposes of increasing the supply of affordable housing and assuring that new affordable housing is dispersed throughout the city. *Id.* at 474. Therefore, the ordinance was intended to provide a benefit to the city as a whole, like other zoning or land use regulations.[6] *Id*.

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[5] The Court found that the City of San Jose's in-lieu fee payment provision was simply an option available to developers who wanted the flexibility that an in-lieu fee provided and allowing the fee payment option did not convert those fees into fees subject to the Mitigation Fee Act. *Id.* at 476.

[6] The Court noted than an earlier decision, *Building Industry Association of Central California v. City of Patterson*, 171 Cal. App. 4th 886 (2009), which invalided the City of Patterson's requirement to construct affordable housing on-site or to pay an in-lieu fee to increase the stock of affordable housing due to the lack of a reasonable relationship, had been incorrectly decided. *Cal. Bldg. Indus. Ass'n*, 61 Cal. 4th at 479.

The Court also distinguished the City of San Jose's ordinance from an earlier decision, *Sterling Park L.P. v. City of Palo Alto*, 57 Cal. 4th 1193 (2013), which analyzed a requirement that developers construct affordable units and give the City of Palo Alto an option to purchase those units or pay an in-lieu fee. The *Sterling Park* decision was focused exclusively on a procedural issue; the requirement that the developer provide the city with an option to purchase was determined to be an exaction pursuant to the Mitigation Fee Act, and the Act's statute of limitations applied. *Cal. Bldg. Indus. Ass'n*, 61 Cal. 4th at 481-82. Nothing in the *Sterling Park* decision supports an argument that the City of San Jose's inclusionary requirements are subject to any different review than any other legislatively required land use requirements. *Id.* at 482.

II. UNDER ASSEMBLY BILL 1505, AN ORDINANCE REQUIRING ON-SITE INCLUSIONARY AFFORDABLE HOUSING MUST PROVIDE FOR ALTERNATIVE MEANS OF COMPLIANCE

In 2017, Assembly Bill 1505 was passed, partly in recognition of the ruling in *California Building Industry Association v. City of San Jose* and partly to address the ruling in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396 (2009). In *Palmer/Sixth Street Properties*, a requirement to provide inclusionary rental housing or pay an in-lieu fee was invalidated due to its conflict with and preemption by the Costa-Hawkins Rental Housing Act (California Civil Code sections 1954.50-1954.535), which protects the right of landlords to establish the initial rental rate for their properties.[7]

A. Assembly Bill 1505 Allows Affordable Rental Units to be Required as a Condition of Residential Development if there are Alternative Means of Compliance

Assembly Bill 1505 amended California Government Code section 65850, which lists types of zoning ordinances, to specify that legislative bodies of cities or counties may adopt ordinances which require, as a condition of residential development, the inclusion of affordable rental units. Cal. Gov't Code § 65850(g).[8] If such an ordinance is adopted, it must provide for alternative means of compliance, which may include in-lieu fees, land dedication, off-site construction of affordable units, or acquisition and rehabilitation of affordable units. *Id.*

Although Government Code section 65850 is not applicable to charter cities, if the City of San Diego chooses to adopt a zoning ordinance that requires on-site affordable housing, this Office recommends allowing an alternative means of compliance. As noted in section I.B, so long as one constitutionally permissible alternative means of compliance is allowed, an ordinance will not be found to be an unconstitutional taking of private property. *Cal. Bldg. Indus. Ass'n*, 61 Cal. 4th at 468.

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[7] This Office summarized the *Palmer/Sixth Street Properties* decision prior to the Council's adoption of amendments to the City's inclusionary housing regulations in 2011. 2011 Op. City Att'y 25 (2011-2; July 15, 2011).

[8] Like much of the California Planning and Zoning Law, Chapter 4, Zoning Regulations, except as otherwise provided, section 65850 is not applicable to charter cities (except as may be adopted by charter or ordinance of the city). Cal. Gov't Code § 65803. The Municipal Code incorporates California Government Code section 65850 by reference only for the purposes of regulating the decision-making process for amendments to the Land Development Code. SDMC § 111.0107(a).

B. Authority of the Department of Housing and Community Development to Review Inclusionary Rental Requirements of More than 15 Percent and to Require Economic Feasibility Studies under Certain Circumstances

Assembly Bill 1505 also enacted California Government Code section 65850.01. This section provides the Department of Housing and Community Development (HCD) with the authority to review an ordinance adopted after September 15, 2017, that requires, as a condition of development of residential rental units, that more than 15 percent of the units be affordable to households at 80 percent or less of the area median income, if either: (1) the jurisdiction has failed to meet at least 75 percent of its regional housing need for the above-moderate income category; or (2) HCD finds that the jurisdiction has not submitted the required housing element report for at least two consecutive years.[9] Cal. Gov't Code § 65850.01(a).

If the ordinance falls under HCD's authority to review, HCD may then require the jurisdiction to submit an economic feasibility study demonstrating that the ordinance does not "unduly constrain the production of housing." Cal. Gov't Code § 65850.01(b). HCD's review of the economic feasibility study is limited to whether: (1) the study was prepared by a qualified entity; (2) the study was made available on the jurisdiction's internet site for at least 30 days, after which it was considered and approved by the legislative body at a regularly scheduled meeting; and (3) the study follows best professional practices and was "sufficiently rigorous" to allow for an assessment of whether the ordinance's inclusionary requirement, in combination with other factors that influence feasibility, is economically feasible. *Id*. If HCD determines that the economic feasibility study does not meet the above standards, the jurisdiction may only require that residential development of rental units provide 15 percent of the units as affordable to households at 80 percent of the area median income, until the jurisdiction submits an economic feasibility study that HCD finds meets the standards above. Cal. Gov't Code § 65850.01(d).

III. INCLUSIONARY HOUSING REQUIREMENTS MAY BE INCLUDED IN SPECIFIC PLANS

The City may consider adopting a zoning ordinance of general applicability as addressed by both *California Building Industry Association* and Assembly Bill 1505. However, as we have previously advised, another option available to the City is to set forth inclusionary housing requirements in specific plans, which contain standards and criteria for development within the specific plan area. Cal. Gov't Code § 65451; SDMC § 122.0107. Like zoning ordinances of general applicability, specific plans may be adopted by ordinance, which provides them with equal authority with the published Municipal Code and may supplant the general Municipal Code requirements.[10] The more specific ordinances adopting the specific plans will prevail over the more general municipal code sections. 58 Cal. Jur. 3d *Statutes* § 20 (2019). However, some alternative means of compliance to providing on-site inclusionary affordable housing, such as the

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[9] Unlike the amendment to California Government Code section 65850, section 65850.01 was expressly made applicable to charter cities. Cal. Gov't Code § 65850.01(g).

[10] The ability to enact specific ordinances that conflict with the published Municipal Code was discussed by this Office previously. 2013 City Att'y MOL No. 29 (2013-4; Apr. 3, 2013).

donation of land, will require the City to develop standards and means of implementation before on-site inclusionary affordable housing may be required. For example, the City should establish standards for the donated land prior to acceptance, which may include the zone and physical conditions such as size.

CONCLUSION

The City may consider adopting a zoning ordinance that requires inclusionary affordable housing to be provided on-site. The zoning ordinance must contain alternatives to this requirement. In addition, the City may consider including inclusionary affordable housing requirements when adopting zoning regulations in specific plans. The adoption of any zoning ordinance that revises the City's inclusionary affordable housing requirements should be based on a record that clearly sets forth the basis for the zoning amendments pursuant to the City's police power to regulate for the general public's health, safety, and welfare.

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RC-2019-3
Doc. No. 1998581_2