

**Office of  
The City Attorney  
City of San Diego**

**MEMORANDUM  
MS 59**

**(619) 533-5800**

**DATE:** October 25, 2013  
**TO:** Honorable Council President and City Council  
**FROM:** City Attorney  
**SUBJECT:** City of San Diego Housing Impact Fee for Nonresidential Development

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**INTRODUCTION**

The San Diego Housing Commission requests that the City Council approve an amendment to the San Diego Municipal Code (SDMC) provisions regarding the Housing Impact Fee on Commercial Development, also known as the “linkage fee,” or, as currently proposed, the Housing Impact Fee for Nonresidential Development or the Workforce Housing Offset Fee (Fee). A nexus study has been prepared for the Council’s consideration to demonstrate that the construction of nonresidential development creates a need for affordable housing and that the proposed Fee amount is less than the cost of providing such housing. The Housing Commission received a copy of an analysis authored by Mr. Walter McNeill that raises various legal concerns related to the proposed amendments to the Fee (McNeill Memorandum). This memorandum responds to the primary concerns raised by Mr. McNeill.

The SDMC currently provides for collection of the Fee at rates approximately equal to 1.5% of 1990 construction costs. The proposed amendment would apply to certain categories of nonresidential development, including commercial and industrial uses, at an initial rate of approximately 1.5% of current construction costs. The SDMC already provides that the Fee is to be adjusted annually, based on a building cost index. The proposed amendment would require the annual adjustment to be made by the Housing Commission instead of the City Council.

## BACKGROUND

The City of San Diego currently charges a fee for nonresidential development, including industrial and commercial development, for the purpose of ensuring that such development contributes its “fair share of the costs of subsidy necessary to house the low and very low income employees who will occupy the jobs new to the region related to such development.” SDMC § 98.0601. These fees, along with funds from other sources, are placed in a Housing Trust Fund within the Affordable Housing Fund. SDMC § 98.0502. The Housing Trust Fund is expended by the Housing Commission for the purposes set forth in Chapter 9, Article 8, Division 5. The purpose of the Affordable Housing Fund is to create a renewable source of revenue to assist in meeting the City’s housing needs for the very low, low, and median income households. SDMC § 98.0501.

The City originally adopted the Housing Impact Fee and enabling ordinances in 1990. *See* San Diego Ordinance O-17454 (Apr. 16, 1990). The ordinance notes various studies relating to the lack of affordable housing, including the City’s Housing Element of the General Plan, which calls for special efforts to encourage an increased supply of affordable housing. *Id.*

In addition, the 1990 ordinance establishes a basis for imposing the Fee on certain commercial development. Primarily, the Council accepted a nexus study that established “a reasonable relationship, or rational nexus between non-residential commercial development projects and increased demand for housing affordable to lower income households” based on the following:

1. New buildings are associated with the attraction of new employees, and new buildings are associated with growth;
2. Employment growth is accompanied by growth in lower income households, specifically a very large portion of new jobs at low income and very low income levels;
3. San Diego was one of the leaders in the nation in 1988 in employment growth, for which a large percent of the jobs were low paying;
4. The nexus study identified the number of employees of varying income levels who work in different types of commercial and industrial buildings, only addressing direct employment and thereby understating the impact of new commercial development on the attraction of lower income households by excluding the employment of the indirect employees, who tend to be at the lower end of the pay scale;
5. The construction of certain types of new commercial development plays a major role in attracting new lower income households to the City of San Diego;
6. The nexus study calculated the number of lower income households attracted to San Diego by new construction of 100,000 square feet of each of six types of commercial development;

7. An affordability gap analysis showed a gap of \$42,500 and \$23,000 in what could be afforded for rental housing for a very low income and low income household of four, respectively; and

8. Based on the affordability gap analysis, the number of very low and low income households employed per 100,000 square foot development in these commercial development types, total supportable fees were calculated to mitigate the impact of the new very low and low income household employment in San Diego.

*Id.*

In addition to these factors, the City Council found that if the current trends in housing supply continued, lower income households would be forced to spend a disproportionately greater percentage of their incomes on housing, and some could eventually become homeless. *Id.* Further, lower income households would be forced to live at greater distances from their employment, causing greater traffic congestion, increased air pollution, and more rapid degradation of the existing infrastructure. *Id.* The limited ability of an inexpensive labor pool to find affordable housing would begin to constrain growth in many sectors in San Diego. *Id.* Therefore, the Council found, it was appropriate to impose some of the costs of the increased burden of providing housing for the low and very low income households that is necessitated by the new commercial development directly on that development. *Id.*

In 1991, the City Council approved a 2% increase in the Fee, and further declared that, in future years, the Fee could be revised by the City Engineer, in consultation with the Housing Commission, and that the Housing Commission was to issue an informational report to the City Council. *See* San Diego Resolution R-277778 (Apr. 23, 1991). In 1996, the City Council amended the Fee to decrease the amounts by 50%. *See* San Diego Ordinance O-18320 (July 8, 1996).

As part of the current proposal, the draft ordinance being presented to the City Council for consideration (Ordinance) would increase the Fee to reflect updated construction costs, require annual revisions to the Fee be made by the Housing Commission based on a building cost index, and provide additional mechanisms by which an applicant could request relief from the Fee, among other actions. To support the Ordinance and the Fee, a new nexus study has been prepared. It is designed to demonstrate the existence of a reasonable relationship between the intended use of the Fee and the amount of the Fee and the impact of development subject to the Fee. Further, it is designed to provide evidence of an essential nexus between the Fee and the City's interest in ensuring an adequate supply of affordable housing and that the Fee is less than an amount that would be roughly proportional to the impact of the development subject to the Fee. The Ordinance prepared for Council's consideration, based on the Housing Commission's recommendations, states that the nexus study demonstrates: a link between the nonresidential development at issue and the occurrence and risk of homelessness; a link between such development and the need for affordable housing; that the Fee would only partially ameliorate

the need for such housing for new workers; and that the nexus study contains other information supporting the Ordinance.

The McNeill Memorandum contends that the Fee is a tax, subject to a two-thirds vote pursuant to Proposition 26. In addition, it asserts that legislatively enacted fees such as the Fee are subject to heightened scrutiny review, in light of the recent U.S. Supreme Court decision in *Koontz v. St. Johns River Water Mgmt. Dist.*, 133 S. Ct. 2586 (2013). This memorandum addresses those contentions.

### QUESTIONS PRESENTED

1. Does approval of the Fee without a vote of the electorate violate Proposition 26?
2. Is the Fee subject to heightened scrutiny in light of the *Koontz* decision?

### SHORT ANSWERS

1. No. The Fee is charged as a condition of property development, and is therefore exempt from Proposition 26.

2. Not likely. In *Koontz*, the Court did not specifically state a legal standard for adoption of legislatively enacted fees. Parties may raise this issue in future litigation. Unless the question is further addressed by the courts, however, it is reasonable to conclude that the state of the law in California with respect to legislatively enacted fees remains as it existed prior to *Koontz*, under which heightened scrutiny would not apply to the Fee.

### ANALYSIS

#### I. THE FEE DOES NOT CONSTITUTE A TAX UNDER PROPOSITION 26

Proposition 26 was passed by the electorate on November 2, 2010. Proposition 26 amended articles XIII A and XIII C of the California Constitution such that “any levy, charge, or exaction of any kind” imposed, increased, or extended by local government agencies on or after November 3, 2010, is considered a tax requiring voter approval.<sup>1</sup> Cal. Const. art. XIII C, § 1. A special tax is a tax imposed for a specific purpose that is placed into a general fund. Cal. Const. art. XIII C § 1(d). A tax must be approved by a majority of the electorate, while special taxes require the approval of two-thirds of the electorate. Cal. Const. art. XIII C, § 2(b), (d). Enumerated exceptions to Proposition 26 apply when the charges or fees are for one of the following purposes, meaning that they are not considered “taxes” under Proposition 26:

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<sup>1</sup> This Office has previously provided general advice regarding Proposition 26. See City Att’y MOL No. 2011-3 (Mar. 4, 2011).

1. A charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of conferring the benefit or granting the privilege.
2. A charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the local government of providing the service or product.
3. A charge imposed for the reasonable regulatory costs to a local government for issuing licenses and permits, performing investigations, inspections, and audits, enforcing agricultural marketing orders, and the administrative enforcement and adjudication thereof.
4. A charge imposed for entrance to or use of local government property, or the purchase, rental, or lease of local government property.
5. A fine, penalty, or other monetary charge imposed by the judicial branch of government or a local government, as a result of a violation of law.
6. *A charge imposed as a condition of property development.*
7. Assessments and property-related fees imposed in accordance with the provisions of Article XIID.

Cal. Const. art. XIII C, § 1(e) (emphasis added).

The government agency imposing a fee bears the burden of proving by a preponderance of the evidence that it is not a tax, that the amount charged is no more than necessary to recover the reasonable costs of the government activity, and that the manner in which the costs are allocated to the payor bears a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity. Cal. Const. art. XIII C, § 1(e)(7); *Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982 (2012).

#### **A. The Fee Is A Charge Imposed As A Condition Of Property Development**

The McNeill Memorandum asserts that the Fee is a tax requiring voter approval because it is not exempt from Proposition 26 as a charge imposed as a condition of development. McNeill Memorandum at 3. This opinion is based on two of the memorandum's conclusions: that the Fee is not a "*development impact fee*" as the Mitigation Fee Act (California Government Code sections 66000 – 66008) defines that term and that only Mitigation Fee Act development impact

fees qualify as exempt from Proposition 26 as charges imposed as a condition of property development.<sup>2</sup>

Proposition 26 is not so specific as to require that conclusion, however. Proposition 26 does not reference the Mitigation Fee Act, and California law authorizes numerous “charges imposed as a condition of property development” aside from the types of charges governed by the Mitigation Fee Act.<sup>3</sup> Such charges may be based on specific statutory authority or they may be imposed pursuant to cities’ police power, which affords cities broad authority to take actions that protect the public health, safety, and welfare provided they do not conflict with general laws. *See* Cal. Const. art. XI, § 7. An example of a non-Mitigation Fee Act fee that cities may impose as a condition of property development is the fee collected pursuant to California Government Code section 65995, which allows the imposition of school impact fees on residential, commercial, or industrial construction. California Government Code section 66477, the Quimby Act, specifically excludes a city’s collection of land or in lieu fees for parks from Mitigation Fee Act requirements. California Public Resources Code section 21002.1(b) requires an agency to mitigate a project’s potentially significant impacts on the environment where it is feasible to do so and title 14, section 15130(a) of the California Code of Regulations allows a project’s cumulative environmental impact to be mitigated by the payment of its fair share of mitigation measures designed to alleviate a cumulative impact. Cities may require fees in order to ensure developments are consistent with the goals of their General Plans.

There is no evidence in the legislative history that would support an interpretation that Proposition 26’s term “charges imposed as a condition of development” was intended to mean only Mitigation Fee Act development impact fees, and no evidence that Proposition 26 intended to call into question those and other development related fee enabling provisions by determining them to be taxes subject to a vote going forward.<sup>4</sup>

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<sup>2</sup> The McNeill Memorandum states, in reference to charges imposed as a condition of property development, “[t]hat particular phrase is a clear reference to development impact fees in Chapter 5 of the Mitigation Fee Act which are charged ‘as a condition of approval of a development project’ (Gov. Code § 66001(a)(b) and imposed ‘as a condition of approval of a proposed development’ (Gov. Code § 66005).” McNeill Memorandum at 3.

<sup>3</sup> *See also* the April 2011 League of Cities Proposition 26 Implementation Guide, “[t]his broad language encompasses more than development . . . fees under the Mitigation Fee Act, Gov. Code §§ 66000 et seq. . . .” referring to the exemption for charges imposed as a condition of property development. *Id.* at 42.

<sup>4</sup> The law related to fees and exactions is evolving. During the course of writing this Memorandum, the California Supreme Court issued an opinion that determined that a city’s demand for a purchase option of a portion of a development’s units at a rate below market for affordable housing purposes was an “exaction” within the meaning of the Mitigation Fee Act such that the developer could use the Mitigation Fee Act’s protest procedures. *Sterling Park, L.P. v. City of Palo Alto*, No. S204771, 2013 WL 564558 (Cal. Oct. 17, 2013). Whether future cases determine that *Sterling Park*’s definition of “exaction” will be expanded to help interpret code sections other than the protest procedure section remains to be seen. If so, and if that interpretation is expanded such that non-Mitigation Fee Act fees such as the Fee at issue here are considered “exactions” under the Mitigation Fee Act, it could be argued that the Mitigation Fee Act’s requirements regarding the need to meet “reasonable relationship” standards to impose certain legislative and ad hoc fees must be satisfied. That issue is discussed later in this Memorandum. For the purposes of the Proposition 26 issue, however, any such determination would only bolster the conclusion that the Fee is not subject to a voter approval requirement.

## **B. The Fee Is Not A Regulatory Fee**

The McNeill Memorandum asserts that the Fee is instead a *regulatory* fee. McNeill Memorandum at 1. The McNeill Memorandum uses this opinion as a basis for a contention that it constitutes a tax under Proposition 26.

As stated above, the City's police power generally allows for the impositions of fees or charges for regulatory purposes. Regulatory fees are those fees "charged in connection with regulatory activities which do not exceed the reasonable cost of providing services necessary to the activity for which the fee is charged and not levied for unrelated revenue purposes." *Griffith*, 207 Cal. App 4th at 905 (upholding annual fees imposed on residential rental properties that funded annual inspections of the rentals, and finding that the City carried its burden of showing that the fees were imposed to cover the costs of the inspections).

"Determining whether an exaction is a fee or a tax has been a recurring chore since 1978 when the voters in California enacted comprehensive and constitutional tax reform." *Cal. Ass'n of Prof'l Scientists v. Dep't of Fish & Game*, 79 Cal. App. 4th 935, 939 (2000). In that case, the court ruled that a flat fee charged by the California Department of Fish and Game for its review of environmental documents was not a tax. The court determined that the cumulative amount of the fees did not exceed the cost of the regulatory program, and that a sufficient reasonable basis was demonstrated for the distribution of the costs amongst the payors. The court reviewed the role played by the Department of Fish and Game in protecting the environment, and noted its many mandatory duties, such as consultations on particular projects, comments on environmental impact reports and timber harvest plans, and monitoring mitigation measures. The court noted that a regulatory program is a government program that protects the health and safety of the public, and the legislative body charged with enacting laws pursuant to its police powers retains the discretion to apportion the costs of that program. *Id.* at 950.

The Fee is charged pursuant to the City's police powers as set forth in article XI, section 7 of the California Constitution as referenced in section 1 of the San Diego City Charter. SDMC § 98.0602. There is no regulatory program and there is no evidence that the Fee is a regulatory fee.<sup>5</sup> For the reasons stated above, the Fee is a charge imposed as a condition of property development and is, therefore, not subject to voter approval pursuant to Proposition 26.

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<sup>5</sup> Even if the Fee were a regulatory fee, Proposition 26 does not characterize all regulatory fees as taxes. The McNeill Memorandum states that regulatory fees "of the type" allowed by the Sinclair Paint decision are "[d]eliberately absent from the list of exceptions for permissible fees;" McNeill Memorandum at 3. Regulatory fees are listed in fact in Proposition 26, however, and their exception from Proposition 26 has been upheld. Cal. Const. art. XIII C, § 1(e)(3); *Griffith v. City of Santa Cruz*, 207 Cal. App. 4th 982 (2012) (citing to *Sinclair Paint Co. v. State Bd. Of Equalization*, 15 Cal. 4th 866 (1997) regarding the government's burden of proof). This Memorandum does not discuss whether the Fee is a regulatory fee as Proposition 26 defines that term because it is not a regulatory fee of any type.

## **II. LEGISLATIVE FEES ARE SUBJECT TO A REASONABLE RELATIONSHIP STANDARD OF REVIEW**

The McNeill Memorandum also asserts that the opinion of the U.S. Supreme Court in *Koontz* establishes new constitutional requirements applicable to the Fee. Specifically, the McNeill Memorandum contends that the Fee is subject to review under a heightened scrutiny standard in accordance with *Nollan v. Cal. Coastal Comm'n*, 483 U.S. 825 (1987) and *Dolan v. City of Tigard*, 512 U.S. 374 (1994), and then concludes that the Fee does not meet that standard.

### **A. Development Exactions Imposed On An Ad Hoc, Adjudicatory Basis Are Subject to Heightened Scrutiny Under the U.S. Constitution**

The Fifth Amendment to the U.S. Constitution contains a provision known as the takings clause. It states that private property shall not “be taken for public use, without just compensation,” and the California Constitution contains a similar limitation on the government’s ability to take private property for a public use. U.S. Const. amend. V; Cal. Const. art. I, § 19. As further described below, application of the rules that apply to takings depends in part on whether the government’s demand is made on an ad hoc basis in the context of an adjudicative (quasi-judicial) setting with respect to a particular property or whether the government’s demand involves an exaction that is part of a legislatively enacted program of general application.

In *Nollan* and *Dolan*, the U.S. Supreme Court examined how the takings clause relates to conditions imposed by governments in the context of making land use decisions. Each case involved a quasi-judicial action whereby the government sought to exact a public access easement from a property owner as a condition of approval of a development permit related to the owner’s property. *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 546 (2005). The *Nollan* Court determined that an “essential nexus” must exist between a legitimate state interest and the exaction in order to pass constitutional muster. In that case, the Court found that there was no essential nexus between the California Coastal Commission’s desire to protect the public’s view of the beach and its requirement that a property owner provide a public access easement across their property. *Nollan*, 483 U.S. at 837. The Court determined that the development condition was not designed to serve the stated governmental purpose. *Id.*

*Dolan* expanded upon this rule by requiring that a second inquiry must be made once the nexus test is met. In *Dolan*, as part of a development approval action, the city sought to limit development in the floodplain and require the owner to provide a bicycle path as an alternative means of transportation. The Court characterized the government’s actions in the *Nollan* case as “gimmickry” that converted a valid land use regulation into a plan of “extortion,” but found that no such gimmickry existed in the case before it. *Dolan*, 512 U.S. at 387. The Court determined that the city’s interests in preventing flooding and reducing traffic congestion were legitimate state interests and that there was an essential nexus between those interests and the exactions. *Id.* at 388. Further, the Court found that there was a need to determine the “degree of connection between the exactions and the projected impact of the proposed development.” *Id.* at 386. In order to require an owner to dedicate private property as part of an adjudicative land use



decision, a “city must make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development.” *Id.* at 391.

Thus, under the rules set forth in *Nollan* and *Dolan*, a government must be able to meet the essential nexus and rough proportionality tests in order to justify a regulatory taking of property as a condition of approval in the context of a quasi-judicial land use decision. Actions that are subject to the *Nollan/Dolan* test are said to be subject to “heightened scrutiny.”

**B. In California, Monetary Exactions Imposed on an Ad Hoc, Adjudicatory Basis Are Also Subject to Heightened Scrutiny**

Subsequently, the California Supreme Court determined that the *Nollan/Dolan* requirements also apply to ad hoc *monetary* exactions imposed as a condition of development approval. *Ehrlich v. City of Culver City*, 12 Cal. 4th 854, 876 (1996). The court identified a nexus between the government’s interest (addressing the social need for public recreational opportunities created as a result of the developer’s project) and imposing a fee to mitigate that impact. *Id.* at 879. The court determined that in order to demonstrate that the “rough proportionality” prong of the *Nollan/Dolan* test is met, a government must make an individualized showing. In that case, the court determined that there was insufficient evidence to justify the *amount* of the fee. Thus, post-*Ehrlich*, the rule in California is that, in order to effect a regulatory taking of property or impose an ad hoc fee as a condition associated with a quasi-judicial land use decision, the government must show that there is an “essential nexus,” and a “rough proportionality” demonstrated by an “individualized determination.”<sup>6</sup>

**C. In California, Legislatively Enacted Fees are Subject To A Reasonable Relationship Standard**

The cases described thus far relate to ad hoc fees. In examining the application of the rules that apply to exactions, various courts have drawn a distinction between such ad hoc exactions and generally applicable, legislatively enacted exactions, and have provided rationale for making such distinctions. *Dolan*, for example, made a specific distinction between the facts before it, which involved “an adjudicative decision to condition petitioner's application for a building permit on an individual parcel” (an ad hoc exaction), and other cases having to do with “legislative determinations classifying entire areas of the city.” *Dolan*, 512 U.S. at 385.

The *Ehrlich* court also drew a distinction between the types of fees before it and generally applicable legislatively enacted fees. It was careful to qualify that its holding only applied to cases in which “such exactions are imposed . . . neither generally nor ministerially, but on an individual and discretionary basis. . . .” *Ehrlich*, 12 Cal. 4th at 876. It provided various reasons for making this distinction. In stating its reasons for requiring heightened scrutiny for ad hoc

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<sup>6</sup> California has applied this law since the *Ehrlich* case was decided in 1996, though courts in other states have applied different rules. Thus, a split of authority developed in the lower courts as to what standard of scrutiny applies to monetary exactions imposed on an ad hoc basis in an adjudicative context.

fees, it noted that “*Nollan* and *Dolan* are thus concerned with implementing one of the fundamental principles of modern takings jurisprudence—‘to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.’” *Ehrlich*, 12 Cal. 4th at 880-81 (citations omitted). The court said that “legislatively formulated development assessments imposed on a broad class of property owners . . . may indeed be subject to a lesser standard of judicial scrutiny than that formulated by the court in *Nollan* and *Dolan* because the heightened risk of the extortionate use of the police power to exact unconstitutional conditions is not present.” *Id.* at 876. The government “generally has greater leeway with respect to noninvasive forms of land use regulation, where the courts have for the most part given greater deference to its power to impose broadly applicable fees, whether in the form of taxes, assessments, user or development fees.” *Id.* at 876.

The *Ehrlich* court further commented that “it is not at all clear that the rationale (and the heightened standard of scrutiny) of *Nollan* and *Dolan* applies to cases in which the exaction takes the form of a *generally* applicable development fee or assessment—cases in which the courts have deferred to legislative and political processes to formulate ‘public program[s] adjusting the benefits and burdens of economic life to promote the common good.’” *Ehrlich*, 12 Cal. 4th at 880-81 (citation omitted). “It is the imposition of land-use conditions in individual cases, authorized by a permit scheme which by its nature allows for both the discretionary deployment of the police power and an enhanced potential for its abuse, that constitutes the sine qua non for application of the . . . standard of scrutiny formulated by the court in *Nollan* and *Dolan*.” *Ehrlich*, 12 Cal. 4th at 869. The concurring opinion commented that the risk of extortionate behavior “diminishes when the fee is formulated according to preexisting statutes or ordinances which purport to rationally allocate the costs of development among a general class of developers or property owners - indeed . . . the separation of powers doctrine clothes such a fee in a presumption of constitutionality.” *Id.* at 899.

In California, the case of *San Remo Hotel L.P. v. City & Cnty of S.F.* adjudicated the matter of what standard applies to legislatively enacted fees. 27 Cal. 4th 643 (2002). The *San Remo* court expressly “decline[d] plaintiffs’ invitation to extend heightened . . . scrutiny to all development fees, adhering instead to the distinction [the Supreme Court of California had drawn in several other cases] between ad hoc exactions and legislatively mandated, formulaic mitigation fees.” *Id.* at 670-671. Instead, it held that “such fees must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development.” *Id.* at 671.

This standard of review is more deferential than the standard the *Ehrlich* court applied to an ad hoc monetary exaction. The *San Remo* opinion set forth the court’s reasoning for applying the lesser standard. To the extent such legislatively mandated fees present some danger of improper leveraging, such fees, which affect an entire class of persons, are already subject to another kind of scrutiny – the scrutiny of the electorate during the democratic political process. *San Remo*, 27 Cal. 4th at 671. In contrast, “ad hoc individual monetary exactions deserve special judicial scrutiny mainly because, affecting fewer citizens and evading systematic assessment, they are more likely to escape such political controls.” *Id.* at 671. Subsequent courts have adopted this

standard. *See Bldg. Indus. Ass'n of Cent. Cal. v. Cnty. of Stanislaus*, 190 Cal. App. 4th 582 (2010). The rule elucidated in *San Remo* has not been overturned.

**D. The U.S. Supreme Court, In *Koontz*, Determined That Monetary Exactions Imposed on an Ad Hoc, Adjudicatory Basis Are Subject to Heightened Scrutiny**

In June 2013, the U.S. Supreme Court issued its opinion in the *Koontz* case. 133 S. Ct. 2586. The McNeill Memorandum argues that *Koontz* requires a heightened standard of review under *Nollan/Dolan* for all monetary exactions that are conditions of property development, whether the exaction is applied on an ad hoc case-by-case basis or as a generally applicable legislatively enacted development fee. McNeill Memorandum at 6.

The underlying facts show that Mr. Koontz had requested permission to build on 3.7 acres of his Florida property while providing a deed-restricted conservation easement as to the remainder of the property. The government denied Mr. Koontz's request after he refused to accept a condition either to: (1) reduce his development to only one acre and provide the easement over the remainder of the property, or (2) build the project he proposed, but pay to improve government-owned wetlands several miles away. *Koontz*, 133 S. Ct. at 2593. The exaction in *Koontz* was an ad hoc exaction. The Court acknowledged that the reason it granted the writ of certiorari under which it agreed to hear the case was because there was a split of authority in the lower courts on the federal constitutional issue of whether ad hoc monetary exactions were subject to heightened scrutiny. *Id.* at 2594.

The case resulted in two holdings. The first was that "the government's demand for property from a land-use permit applicant must satisfy the requirements of *Nollan* and *Dolan* even when the government denies the permit and even when its demand is for money." *Koontz*, 133 S. Ct. at 2603. On this issue, the justices determined that a petitioner may state a takings claim even when its permit has been denied. The Court held that whether the *Nollan/Dolan* standard applies does not depend on "whether the government approves a permit on the condition that the applicant turns over property or denies a permit because the applicant refuses to do so." *Id.* at 2595 (emphasis omitted). This holding is not directly relevant to the Fee issue before the Council.

The second of the *Koontz* holdings was that monetary exactions must satisfy *Nollan/Dolan* requirements. *Id.* at 2599. The opinion qualified that rule, however. It explained that its opinion on this issue was based on the fact that the government's demand for money "burdened petitioner's ownership of a specific parcel of land" in that the circumstances posed a "risk that the government may use its substantial power and discretion in land-use permitting to pursue governmental ends that lack an essential nexus and rough proportionality to the effects of the proposed new use of the specific property at issue, thereby diminishing without justification the value of the property." *Id.* at 2599-600.

In deciding that monetary exactions imposed as a condition of development on an ad hoc basis as part of an adjudicative matter, *Koontz* settled that split of authority that had existed in the lower courts on that issue. In doing so, it cited various examples of the lower court divide, including

*McClung v. City of Sumner*, 548 F. 3d 1219 (9th Cir. 2008) and *Ehrlich*, 12 Cal. 4th 854.<sup>7</sup> *Id.* Both *McClung* and *Ehrlich* agreed that *Nollan/Dolan* does not apply to generally applicable legislatively enacted fees. *McClung*, 548 F.3d at 1227-28; *Ehrlich*, 12 Cal. 4th 876, 881. However, while *Ehrlich* held that *Nollan/Dolan* applies to monetary exactions, *McClung* opined that *Nollan/Dolan* does not. *McClung*, 548 F.3d at 1228. The divide addressed by the Court, as applicable to the case before it, was whether *Nollan/Dolan* applies to ad hoc monetary exactions; in holding that it does, the Court implicitly agreed with *Ehrlich* on that point.

As discussed above, in California, the *Ehrlich* court had already determined that monetary exactions imposed on an ad hoc basis as a condition of development were subject to heightened scrutiny. On that issue, *Koontz* did not change the rule that has existed in California since 1996. According to the McNeill Memorandum, however, *Koontz* also made *legislative* fees subject to heightened scrutiny. The *Koontz* opinion does not lend clear support to such an assertion. Notably, the monetary exaction at issue in *Koontz* involved a demand for money on a particular individual project, and *Koontz* does not discuss the application of *Nollan/Dolan* to any other types of fees. Also, *Koontz* was not decided for the purpose of distinguishing between ad hoc and generally applicable legislatively enacted fees; it was decided for the purpose of resolving a divide amongst lower courts on “whether a demand for money can give rise to a claim under *Nollan* and *Dolan*.” *Koontz*, 133 S. Ct. at 2594. On that basis, it is this Office’s opinion that although *Koontz* – consistent with *Ehrlich* – holds that *Nollan/Dolan* applies to monetary exactions that burden the ownership of a particular parcel of land when they are imposed on an ad hoc basis in an adjudicatory setting, it does not explicitly or impliedly extend *Nollan/Dolan* to generally applicable legislatively enacted fees.

In fact, the *Koontz* opinion is clear that the issue is one that the U.S. Supreme Court did not reconcile in *Koontz*. Although the majority explicitly stated that *Nollan/Dolan* does not apply to taxes and user fees, it did not supply any specific rule for legislatively enacted monetary exactions related to development. *Koontz*, 133 S. Ct. at 2601. The dissenting opinion laments that the majority does not address this issue. As an example, it acknowledges that California already has an applicable rule. The opinion describes *Ehrlich*’s rule that “*Nollan* and *Dolan* apply only to permitting fees that are imposed ad hoc, and not to fees that are generally applicable[.]” saying that, “[m]aybe today’s majority accepts that distinction; or then again, maybe not.” *Id.* at 2608. Due to the fact that *Koontz* did not opine on the issue of the standard applicable to legislative fees, its opinion left undisturbed the jurisprudence that had previously dealt with it. Thus, the state of the law in California related to legislatively enacted fees is the same as prior to the *Koontz* decision. There is evidence that supports the idea that the Court acknowledged that it was leaving laws such as California’s undisturbed: the majority opinion stated that “[t]his case therefore does not affect the ability of governments to impose property taxes, user fees, and similar laws and regulations that may impose financial burdens on property

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<sup>7</sup> It also cited to *Town of Flower Mound v. Stafford Estates Ltd. P’ship*, 135 S.W.3d 620, 640-41 (Tex. 2004). *Flower Mound* agreed with *Ehrlich* that there is no important distinction between an exaction for land and an exaction that requires the payment of money toward an improvement, further showing the divide amongst the lower courts on the issue. *Flower Mound*, 135 S.W. 3d at 640. *Flower Mound* also specifically declined to categorically decide whether all legislative decisions are subject to *Dolan*. *Id.* at 642.

owners.” *Koontz* at 2602. In California, that rule is the one stated by the *San Remo* court as described herein.

In failing to specifically address the issue of whether *Nollan/Dolan* applies to generally applicable legislatively enacted fees, *Koontz* opened the door for future litigation on that issue. Due to the fact the *Koontz* court did not make a distinction when it rendered its opinion, opponents of such fees will likely see this as an opportunity to argue that the Court’s rule means that all development fees are subject to heightened scrutiny. The McNeill Memorandum represents one such opinion.

Although this Office’s interpretation of the *Koontz* decision is narrower than Mr. McNeill’s, the difference of opinion need not necessarily be resolved in order for the Council to make a decision regarding the adoption of this Ordinance. The nexus study prepared for Council’s consideration of the Ordinance purports to satisfy both the Mitigation Fee Act standards as well as the *Nollan/Dolan* heightened scrutiny standards for monetary exactions imposed as a condition of development, as if they did apply to the Ordinance.<sup>8</sup> See Jobs-Housing Nexus Study prepared by Keyser Marston Associates, Inc., August 2013 at 2. The nexus study states that it “yields a connection between new construction of the types of buildings in which there are workers and the need for additional affordable housing, a connection that is quantified both in terms of number of units and the amount of subsidy assistance needed to make the units affordable.” Jobs-Housing Nexus Study at 4.

## CONCLUSION

The Fee is exempt from Proposition 26 because it is a fee imposed as a condition of property development and is thus not a tax requiring voter approval. The stated purpose of the Fee is to offset the need for affordable housing created by the nonresidential development that is subject to the Fee. The *Koontz* opinion did not specifically overturn California law relevant to the requirements for adopting generally applicable legislatively enacted fees.

The Fee, which is a generally applicable legislatively enacted fee, is most likely subject to a reasonable relationship standard of review. The Council must review the evidence in the record, including the prepared nexus study, to determine whether the Fee bears a reasonable relationship in use and amount to the burdens posed by the development subject to the Fee. If the Council can make this determination, it would have a legal basis for adoption of the Fee under the reasonable relationship standard. Should the Council instead apply a heightened scrutiny standard, the Council would need to review the evidence in the record, including the prepared nexus study, to determine whether there is an essential nexus between a legitimate state interest and the fee

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<sup>8</sup> The Mitigation Fee Act establishes that generally applicable fees must meet reasonable relationship requirements (between both the fee’s use and the type of development and between the type of development and the need for the public facility), that ad hoc fees must also meet a reasonable relationship requirement (between the amount of the fee and the cost of the facility, like *Dolan*’s rough proportionality standard), and that fees and exactions must not exceed the cost of providing the service or facility for which they are imposed. See Cal. Gov. Code §§ 66001, 66005; *Ehrlich*, 12 Cal. 4th at 864-867.

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requirement and whether the evidence contains an individualized showing that the nature and extent of the Fee is roughly proportional to the impact of the development subject to the Fee. If the Council were to make this determination, it would have a legal basis for adoption of the Fee under the heightened scrutiny standard.

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