



## **Inclusionary Housing in California: The Legal Landscape**

With the signing of 2017’s landmark housing package, California restored local governments’ ability to apply locally adopted inclusionary housing requirements—which generally mandate that private housing developers include affordable units in their projects—to rental housing.<sup>1</sup> The legislation, combined with recent court decisions upholding the validity of local inclusionary requirements, creates a powerful tool for local governments to wield when crafting policies to promote development that benefits all segments of their community.

### **A Brief History of Inclusionary Housing**

Inclusionary housing ordinances in California “were instituted as a response to . . . exclusionary zoning[], to severe shortages of affordable housing combined with a reduction of federal housing subsidies, and to legal pressures in California and New Jersey.”<sup>2</sup> Those legal pressures included the seminal lawsuit filed in New Jersey when a group of low-income African-American and Puerto Rican residents sought to build affordable housing in the Township of Mount Laurel, which maintained exclusionary single-family zoning practices. After that group mounted a legal challenge to the township’s exclusionary practices, the Supreme Court of New Jersey declared that municipalities had an “affirmative obligation” to meet their “fair share” of the regional need for low- and moderate-income housing.<sup>3</sup> Later, in enforcing its prior decision, the court found that an affirmative obligation to provide housing opportunities for families of all social strata can sometimes only be satisfied through the use of inclusionary policies.<sup>4</sup> These principles became a blueprint for numerous municipalities across the country, including in California, to promote economic and racial integration within their jurisdictions.

California declared an affirmative legal obligation to meet fair share housing requirements in the state Housing Element Law, enacted in 1969.<sup>5</sup> Under the law, “[l]ocal and state governments have a responsibility to use the powers vested in them to facilitate the improvement and development of housing to make adequate provision

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<sup>1</sup> AB 1505 (Bloom), Chapter 376, Statutes of 2017.

<sup>2</sup> Barbara Erlich Kautz, In Defense of Inclusionary Zoning: Successfully Creating Affordable Housing, 36 U.S.F. L. REV. 971, 972 (2002).

<sup>3</sup> *S. Burlington County N.A.A.C.P. et al. v. Township of Mount Laurel*, 336 A.2d 713, 727-8. (N.J. 1975) (*Mt. Laurel I*).

<sup>4</sup> *S. Burlington Cnty. N.A.A.C.P. v. Mount Laurel Twp.*, 456 A.2d 390, 449 (N.J. 1983) (*Mt. Laurel II*).

<sup>5</sup> Cal. Gov’t Code §§ 65580 et seq.



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for the housing needs of all economic segments of the community.”<sup>6</sup> Local jurisdictions that receive federal funding similarly have a duty to reverse the harmful effects of exclusionary zoning under the federal duty to affirmatively further fair housing.<sup>7</sup> In addition, California law now requires cities and counties to affirmatively further fair housing in the administration of their housing and community development activities.<sup>8</sup> These issues continue to be pressing to this day, and as the New Jersey Supreme Court noted, inclusionary housing policies remain one of the only ways for cities and counties to address them.

### **The Problem with 2009: *Palmer and Patterson***

By 2007, over 170 California jurisdictions had adopted inclusionary housing policies, encompassing mandates for rental, for-sale, or a combination of rental and for-sale units.<sup>9</sup> Then, in 2009, two Court of Appeal decisions created uncertainty around inclusionary ordinances: *Palmer/Sixth St. Properties, L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396 (2009) and *Building Industry Assn. of Central California v. City of Patterson*, 171 Cal.App.4th 886 (2009).

#### *The Palmer Decision*

In *Palmer/Sixth St. Properties, L.P. v. City of Los Angeles*, a developer challenged a mandatory rental inclusionary requirement included in a specific plan governing development in a portion of Los Angeles. He argued that the Costa-Hawkins Rental Housing Act, a law that limits rent control in residential tenancies, prohibited the imposition of mandatory inclusionary policies in rental housing. Costa-Hawkins, in relevant part, states “[n]otwithstanding any other provision of law, all residential landlords may, except in specified situations, ‘establish the initial rental rate for a dwelling or unit.’”<sup>10</sup> Though the Legislature never considered or addressed inclusionary ordinances when passing Costa-Hawkins, the Court of Appeal agreed with the developer.<sup>11</sup> The court’s decision effectively made invalid local inclusionary requirements imposed on rental housing and any in lieu fees associated with them. Importantly, local for-sale inclusionary requirements remained valid.

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<sup>6</sup> Cal. Gov’t Code § 65580(d).

<sup>7</sup> 42 U.S.C. §3608.

<sup>8</sup> AB 686 (Santiago), Chapter 958, Statutes of 2018

<sup>9</sup> Non-Profit Housing Association of Northern California, *Affordable by Choice: Trends in California Inclusionary Housing Programs* (2007).

<sup>10</sup> *Palmer/Sixth St. Properties, L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396, 1410–11, 96 Cal. Rptr. 3d 875, 886 (2009).

<sup>11</sup> *Id.* at 886-87.



### The Patterson Decision

In a much narrower holding, another Court of Appeal determined that an in lieu fee associated with the City of Patterson’s inclusionary ordinance was not “‘reasonably justified’ as required by the development agreement for the project at issue unless there [was] a reasonable relationship between the amount of the fee, as increased, and ‘the deleterious public impact of the development.’”<sup>12</sup> The court’s decision was based on the language of the development agreement, the unusual formula the city used to determine the in lieu fee, and the failure of the City of Patterson to articulate an alternative formula. The decision created some uncertainty, temporarily, as to what standard of review courts would use when assessing the validity of an inclusionary ordinance, whether applicable to for sale or rental units.

The combination of the *Palmer* and *Patterson* decisions created some uncertainty in the landscape of the law applicable to inclusionary housing ordinances for several years. Fortunately, recent legislation and court decisions have clarified the law and affirmed the continuing validity and importance of such local measures.

### **Present Opportunities**

Two critical changes in the law related to inclusionary housing have occurred in the last several years. First, the California Supreme Court has clarified that the validity of inclusionary housing ordinances should be judged by the traditional standard applicable to a locality’s exercise of its police powers: whether they are “reasonably related to the broad general welfare purposes for which the ordinance was enacted.”<sup>13</sup> Second, the Governor signed AB 1505, which reinstated a municipality’s right to apply inclusionary requirements to rental housing.

### The CBIA Decision

Two main issues in *CBIA v. City of San Jose* were: 1) whether San Jose’s local inclusionary ordinance was an unconstitutional exaction as outlined in the United States Supreme Court’s *Nollan/Dolan* line of cases; and 2) whether the City’s inclusionary ordinance was subject to the *San Remo* standard that the ordinance be “reasonably related to the impact of a particular development to which the ordinance applies.”<sup>14</sup>

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<sup>12</sup> *Bldg. Indus. Assn. of Cent. California v. City of Patterson*, 171 Cal. App. 4th 886, 898 (2009) (disapproved of by *California Bldg. Indus. Assn. v. City of San Jose*, 61 Cal. 4th 435 (2015)).

<sup>13</sup> *California Bldg. Indus. Assn. v. City of San Jose*, 61 Cal. 4th 435, 474 (2015).

<sup>14</sup> *San Remo Hotel v. City and County of San Francisco*, 27 Cal.4th 643, 663–664 (2002), relating to the Mitigation Fee Act.



First, the court held that the ordinance was not an exaction. To constitute an exaction, the ordinance would have had to “require a developer to give up a property interest for which the government would have been required to pay just compensation under the takings clause outside of the permit process.”<sup>15</sup> The court reasoned that the law was akin to land use regulations that restrict usage of the property (i.e., setbacks, density requirements, etc.) and price controls (i.e., rent stabilization), which have been held to be constitutional and do not require just compensation.<sup>16</sup> Accordingly, restricting the amount for which a developer can sell or rent a unit is subject only to the same review as any other land use regulation.

Second, the court held that the city need only show that the ordinance is reasonably related to the broad general welfare purposes for which it was enacted, meaning the *San Remo* standard did not apply. This decision expressly overturned *Patterson* “to the extent it indicates that the conditions imposed by an inclusionary housing ordinance are valid only if they are reasonably related to the need for affordable housing attributable to the projects to which the ordinance applies.”<sup>17</sup> The court found that the higher standard found in *San Remo* is intended to apply “to permit conditions that require the payment of monetary fees,” not land use regulations.<sup>18</sup> Even more narrowly, the court found that the *San Remo* standard only applies to development mitigation fees.<sup>19</sup> In distinguishing *San Remo* and overturning *Patterson*, the court noted that San Jose’s law was passed in order to allow the city to meet its affordable housing goals and to ensure that new economically diverse affordable housing was spread throughout the city. In short, pursuant to *CBIA*, cities and counties are free to impose inclusionary requirements based on their broad police powers.

### *The Palmer Fix: AB1505*

In 2017, Governor Brown signed the long-awaited *Palmer* fix, once again allowing municipalities to apply inclusionary requirements to rental housing. However, the fix imposes some new standards for the imposition of those restrictions.

Government Code §65850(g) states that cities may:

“Require, as a condition of the development of residential rental units, that the development include a certain percentage of residential rental units affordable to, and

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<sup>15</sup> *California Bldg. Indus. Assn. v. City of San Jose*, 61 Cal. 4th 435, 461 (2015).

<sup>16</sup> *Id.* at 461-464.

<sup>17</sup> *Id.* at 479

<sup>18</sup> *Id.* at 472

<sup>19</sup> *Id.* at 473



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occupied by, households with incomes that do not exceed the limits for moderate-income, lower income, very low income, or extremely low income households. . .”

This first section reinstates the law as it was prior to *Palmer*. However, it continues:

“The ordinance shall provide alternative means of compliance that may include, but are not limited to, in-lieu fees, land dedication, off-site construction, or acquisition and rehabilitation of existing units.”

By that language, the fix creates a new requirement that a municipality’s local inclusionary ordinance, as applied to rental housing, must include alternative means of compliance other than the construction of affordable rental units on site in a housing development. While the statute provides examples of alternatives, it does not provide an exhaustive list of what those alternatives could be or when they must be granted, leaving it up to cities and counties to decide. As a practical matter, nearly all inclusionary ordinances adopted in California prior to the passage of AB 1505 had already included alternative means of compliance under certain circumstances.

The second portion of AB 1505 allows the Department of Housing and Community Development (HCD) to review local inclusionary ordinances in specific, limited circumstances. Specifically, Government Code §65850.01 authorizes HCD to review a local inclusionary ordinance if all of the following apply:

1. The ordinance was adopted or amended after September 15, 2017, and no more than 10 years have passed since the adoption or most recent amendment of the ordinance.
2. The ordinance requires that more than 15% of the total units in a residential rental development be affordable to occupants at or below 80% of area median income (i.e, lower-income households).
3. The jurisdiction, according to its annual housing element report, has not met at least 75% of its above-moderate share of the regional housing need over at least a five-year period (prorated based on the length of time within the planning period pursuant to Gov’t Code 65588(f)(1)), or the jurisdiction has not submitted the annual housing element report for at least two consecutive years.

If all of these conditions apply, then HCD may request, and the local jurisdiction must provide within 180 days, an economic feasibility study demonstrating that “the ordinance does not unduly constrain the production of housing.”<sup>20</sup> Leaving aside best

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<sup>20</sup> Gov’t Code §65850.01(b).



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practices, the feasibility study is only required if HCD has requested it pursuant to its aforementioned authority; it is not required in order to pass a valid ordinance.

Once a jurisdiction submits a requested economic feasibility analysis, HCD can only review it to determine the following:

1. The preparer of the study is a qualified entity with demonstrated expertise in the area.
2. The study was available on the jurisdiction's website for at least 30 days and then considered at a regularly scheduled legislative meeting prior to approval.
3. The study was sufficiently rigorous and followed best professional practices.

Importantly, HCD's authority does not extend to imposing its own analysis of economic feasibility. Once a jurisdiction has submitted the study, HCD has 90 days to determine whether the study meets the requirements described above. If HCD finds that it does not and the jurisdiction disagrees with HCD's negative determination, it may appeal to the Director of HCD or his or her designee. The Director or designee must then make a decision within 90 days of receipt of the appeal.

If a jurisdiction fails to submit the required feasibility study within 180 days or HCD makes a final determination that the study does not meet the prescribed requirements, the ordinance is still valid. However, until the jurisdiction submits a feasibility study that HCD determines meets the prescribed requirements, it may not impose a requirement to include units affordable to households at 80% of area median income in excess of 15%.

With the resolution of several outstanding legal issues that have clouded the policy choices on inclusionary housing in recent years, local governments once again have clear authority to enact these policies for both rental and for-sale housing. Inclusionary housing policies remain an important local tool for increasing the supply of affordable housing and building equitable, inclusive communities.

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