Adjusting to *Palmer*

Palmer Decision Affects Redevelopment Agencies' Ability to Rely on Local Inclusionary Housing Ordinances to Meet Their Production Requirements.

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Over the last several years, many communities have enacted local inclusionary housing ordinances to produce a portion of the community's affordable housing stock. Many redevelopment agencies have relied on these local inclusionary housing ordinances to help meet the mandate under the California Redevelopment Law (CRL) that 15 percent of the housing units produced in redevelopment areas be affordable (6 percent to very low-income households, 9 percent to low- or moderate-income households).

However, in *Palmer/Sixth Street Properties L.P. v. City of Los Angeles (Palmer)*[1], the California Court of Appeal held that local inclusionary requirements applied to rental housing and in-lieu fees based on those requirements violate the Costa-Hawkins Act—the State law governing rent control. The *Palmer* decision has significant implications for local inclusionary ordinances and therefore affects redevelopment agencies' ability to rely on these ordinances to meet their production requirements. *Palmer* does not end inclusionary zoning in the state, but it likely requires changes in local inclusionary ordinances and policies.

Palmer arose out of the City of Los Angeles' specific plan for Central City West, which required developers to either reserve 15 percent of new units for low-income households, or replace any low-income units that had been demolished, whichever resulted in more units. The requirements were based on planning studies showing that new development was reducing the area's affordable housing stock. As part of his 350-unit development, Geoff Palmer was required to replace 60 low-income units that had been previously demolished on the site or, alternatively, to pay an in-lieu fee of approximately $96,200 per low-income unit. The in-lieu fee was equal to the cost to the City of providing the below-market rate (BMR) units.

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Adopted by the Legislature in August 1995, Costa-Hawkins allows landlords to set the initial rent for a new unit and to increase the rent to market levels whenever a unit is vacated (so-called "vacancy decontrol"). The Court concluded that the City's affordable housing condition was "clearly hostile" to Palmer's right to set the initial rental rate because it limited the rents that Palmer could charge. The Court further found that—because the objective of the City's ordinance was to impose affordable housing requirements and because the amount of the in-lieu fee was based on the number of BMR units required—the in-lieu fee was "inextricably intertwined" with the preempted rent control option and was preempted by Costa-Hawkins.

In a footnote, the Court stated that if the base requirement of the ordinance had been an in-lieu fee, with voluntary provision of rental BMR units as an alternative, both the fee and the voluntary provision of units would be part of "an overall plan that is

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[1] 175 Cal. App. 4th 1396 (2009).

preempted by [Costa-Hawkins]" and illegal.

The restrictions of Costa-Hawkins do not apply if: (1) the owner of the rental housing development receives direct financial assistance or any incentive of the type specified in density bonus law (which includes a wide variety of regulatory relief), and (2) the developer agrees by contract to limit rents for BMR rental units. Palmer, however, had not received any bonuses, incentives, or financial assistance.

Palmer has these implications for local inclusionary requirements:

- Affordable rental housing cannot be required in newly-created rental developments receiving no assistance or incentives from local government.
- Rents may be limited if the builder receives either a financial contribution or a type of assistance specified in density bonus law and agrees by contract to restrict the rents.
- Affordable housing requirements imposed on for-sale housing are not affected by *Palmer*.

Communities still have the ability to produce rental BMR units provided they meet the established statutory exception to Costa-Hawkins. Redevelopment agencies frequently use their low- and moderate-income housing funds to assist rental housing projects in exchange for affordability covenants of 55 years or more. This type of assistance in exchange for rental restrictions fits clearly within the exceptions to Costa-Hawkins, and should not be affected by *Palmer*. Thus, *Palmer* should have no impact on agencies' ability to assist affordable rental housing with their low- and moderate-income housing funds.

There are other potential steps that communities may wish to consider to mitigate *Palmer's* effect on their stock of affordable rental housing. For development projects with a recorded condominium map or other subdivision map allowing units to be sold individually—a locality may require the provision of ownership BMR units as a condition of map approval. However, State law gives the developer the option of providing the required BMR units as rentals (Government Code Section 65589.8). To achieve consistency between this provision and Costa-Hawkins, if the developer asks to provide the BMR units as rentals, the developer must enter into an agreement with the locality agreeing to the limitation on rents in exchange for a regulatory or financial incentive.

Palmer did not consider residential housing mitigation fees. While the Court of Appeal invalidated the fee charged by the City of Los Angeles in-lieu of the prohibited requirement that affordable rental housing be provided, it did not consider a fee imposed on rental housing to mitigate the impacts of the construction of market-rate rental housing on the need for affordable housing. Some communities have conducted "nexus" studies to determine the extent of any impacts created by new market rate rental housing and charged fees based on those studies.

Finally, the Court did not consider the interplay and obvious tension between CRL-imposed production requirements and Costa-Hawkins. Communities should consult with their legal counsel about the ability to impose affordable housing requirements on rental developments through contracts with developers, property owners, or other means.

Responses to *Palmer* will require careful coordination between redevelopment agency staff and their counterparts in city planning and housing departments in order to comply with *Palmer* and provide redevelopment agencies with the tools to meet their housing production requirements. Most inclusionary housing ordinances and policies will need to be modified to ensure consistency with *Palmer*. Careful coordination between departments will ensure that incentives already being provided to developers are leveraged to minimize the community's costs to comply with both Costa-Hawkins and the CRL housing production requirements.

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