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MEMORANDUM FOR: Planning Directors and Interested Parties

FROM: Zachary Olmstead, Deputy Director
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SUBJECT: **Rental Inclusionary Housing**
Chapter 486, Statutes of 2017 (Assembly Bill 1505)

This memorandum provides guidance regarding Assembly Bill (AB) 1505 (Chapter 486, Statutes of 2017), effective January 1, 2018.

AB 1505 authorizes the legislative body of any city or county to adopt an inclusionary housing ordinance that includes residential rental units affordable to lower- and moderate-income households (Government Code, § 65850, subd. (g).)

Among other things, this bill specifies:

- requirements for alternative means of compliance for inclusionary ordinances,
- parameters for the California Department of Housing and Community Development (HCD) review of inclusionary housing ordinances, under limited circumstances, by requesting the submittal of an economic feasibility study to ensure the ordinance does not unduly constrain the production of housing, and
- criteria for HCD to review economic feasibility studies.

Copies of bills and other materials from the 2017-2018 session can be obtained at http://leginfo.legislature.ca.gov/ or the legislative Bill Room at 916-445-2323. For additional information or questions, please contact the Division of Housing Policy Development at (916) 263-2911.

BACKGROUND AND INTENT OF AB 1505

Article XI, section 7 of the California Constitution grants each city and county the power "to make and enforce within its limits all local, police, sanitary and other ordinances and regulations not in conflict with general laws." This is generally referred to as the police power of local governments. The Planning and Zoning Law (Gov. Code, §§ 65000 to 66035) sets forth minimum standards for cities and counties to follow in land use regulation, but the law also establishes the Legislature's intent to "provide only a minimum of limitation in order that counties and cities may exercise the maximum degree of control over local zoning matters." (Government Code § 65800).

Many jurisdictions, pursuant to their police power, adopted inclusionary housing requirements that require developers to ensure that a certain percentage of housing units in a new development be affordable to moderate- and lower-income households. Most, if not all, of such requirements applied to both rental and ownership housing.

Legislative Findings on AB 1505

"Inclusionary housing ordinances have provided quality affordable housing to over 80,000 Californians, including the production of an estimated 30,000 units of affordable housing in the last decade alone. Since the 1970s, over 170 jurisdictions have enacted inclusionary housing ordinances to meet their affordable housing needs."

Despite the many local inclusionary requirements, court decisions changed the environment regarding rental inclusionary requirements. In 2009, in *Palmer/Sixth Street Properties, L.P. v. City of Los Angeles* (2009) 175 Cal.App.4th 1396, the Second District California Court of Appeal opined that the city's inclusionary housing requirements associated with a specific plan, as applied to rental housing, conflicted with, and were preempted by, a state law known as the Costa-Hawkins Rental Housing Act. (Civil Code, §§ 1954.50 to 1954.535.)

The Costa-Hawkins Act, adopted in 1995, allows landlords to set the initial rent for a new unit and to increase the rent to market levels whenever a unit is vacated. The Court of Appeal concluded that the city's inclusionary requirement clearly conflicted with Palmer's right to set the rental rate for his units because the City would limit the rent that he could charge for the affordable units. After the *Palmer* decision, most jurisdictions with inclusionary housing ordinances that included rental housing stopped applying the inclusionary requirements on rental housing development.

In response to the court cases, AB 1505 supersedes the holding and dicta in the *Palmer/Sixth Street Properties* case to the extent that the decision conflicts with a local jurisdiction's authority to adopt inclusionary housing ordinances on residential rental unit developments. The enactment of AB 1505 reaffirms the authority of local governments to include rental units within inclusionary ordinance requirements and adds a limited HCD review, under certain circumstances, of economic feasibility studies to demonstrate the ordinance does not unduly constrain the production of housing.

LOCAL AUTHORITY

While local governments have long held the authority to adopt ordinances and regulate land use, recent court cases made that authority relative to rental inclusionary housing less clear. In response, AB 1505 provides clear authority that all cities and counties, including charter cities and counties, may adopt ordinances that require, as a condition of development, a certain percentage of rental units affordable to lower- or moderate-income households, including very low and extremely low- income households, and to reaffirm adoption of the same be conducted openly, consistent with the Ralph M. Brown Act.

California Building Assn. V. of San Jose (2015) 61 Cal.4th 435

In 2010, the City of San Jose adopted an inclusionary housing ordinance that applied a 15 percent inclusionary requirement for lower- and moderate-income households. The California Building Industry Association (CBIA) filed a lawsuit alleging that inclusionary requirements were an “exaction" that needed to be justified by the impact of the project, like traffic fees. The California Supreme Court ruled that inclusionary requirements are not “exactions.” Rather, the ruling stated that enforcing affordable housing requirements to address a growing housing problem is “constitutionally legitimate” so long as it "bears a real and substantial relationship to the public interest", and cited the need to increase the number of affordable units given the severe scarcity of affordable housing in California, and the desirability of having economically diverse communities.

In clarifying this authority, AB 1505 also recognizes the importance of flexibility and mitigating development costs in meeting inclusionary requirements. The law states that inclusionary ordinances with rental housing must provide alternative means for compliance. Local governments may seek alternative means of compliance such as in-lieu fees, land dedication, off-site construction, or acquisition and rehabilitation of existing units. This list of alternative means is not exhaustive, and a local government could include additional means. A local government may also wish to consider other factors when allowing alternative means such as land dedication, off-site construction, and acquisition and rehabilitation. Examples include strategic locations that minimize displacement, improve access to jobs and transportation, or improve a community’s inclusiveness.

HCD REVIEW AUTHORITY

Since 1969, California has required that all jurisdictions (cities and counties) adequately plan to meet the housing needs of everyone in the community. California's local governments meet this requirement by adopting Housing Elements as part of their general plan pursuant to Gov. Code section 65580. Housing Elements are adopted every five to eight years and are subject to HCD review.

Pursuant to Government Code section 65583(a)(5), a jurisdiction's Housing Element must include an analysis of potential and actual governmental constraints upon the maintenance, improvement, or development of housing for all income levels, including, but not limited to, land use controls, fees and other exactions required of developers, local processing and permit procedures, and any locally adopted ordinances that directly impact the cost and supply of residential development. The element must also address and, where appropriate and legally possible, remove governmental constraints to the maintenance, improvement, and development of housing. As an inclusionary ordinance falls under this requirement, the Housing Element must include a description and analysis of the inclusionary housing ordinance framework, which would then be subject to HCD review. For more guidance on this analysis, please see the HCD's Building Blocks Webpage.

AB 1505 provides HCD authority to review economic feasibility studies related to rental inclusionary housing ordinances. However, HCD is not required to review these economic feasibility studies and local governments are only required to submit the studies upon HCD request after meeting several other conditions (see below). Further, HCD will not review the actual inclusionary ordinance pursuant to AB 1505. HCD's review is limited to a review of an economic feasibility study that provides evidence that the ordinance does not unduly constrain the production of housing. AB 1505 did not alter HCD's review authority of inclusionary ordinances, rental and owner, as part of its obligation to review Housing Elements of the general plan.

CONDITIONS TRIGGERING SUBMITTAL TO HCD

Local governments are only required to submit economic feasibility studies if specified conditions exist:

- *Rental Inclusionary*: AB 1505 only applies to ordinances with rental inclusionary requirements. Ordinances with only ownership housing do not trigger requirements under AB 1505.

- *Adopted or Amended Post September 15, 2017*: Local governments who do not adopt or amend ordinances after September 15, 2017, do not trigger AB 1505 and are not required to prepare or submit economic feasibility studies to HCD.

Jurisdictions adopting or amending ordinances after September 15, 2017, may consider conducting an economic feasibility study prior to the adoption or amendment of an inclusionary housing ordinance, but are not required to do so.

- *Level of Affordability*: Only inclusionary ordinances that require more than 15 percent of the total number of units to be rented by households at 80 percent or less of area median income (AMI) are subject to AB 1505. Inclusionary ordinances that require less than 15 percent for 80 percent or less AMI household, or solely target household above 80 percent of AMI, do not trigger a submittal or review by HCD under AB 1505.

- *HCD Findings*: HCD may review any inclusionary rental-housing ordinance if it finds either of the following apply:

  (1) The jurisdiction failed to meet at least 75 percent of its share of its above-moderate income Regional Housing Need Allocation (RHNA) (prorated based on the length of time within the planning period) over at least a five-year period, based on the jurisdiction's annual Housing Element report; or

  (2) The jurisdiction failed to submit the annual Housing Element report for at least two consecutive years.

Annual Progress Reports

Local governments are required to submit Annual Progress Reports on implementation of the general plan pursuant to Gov. Code section 65400. The report includes progress toward the RHNA by income group. HCD makes that data available through interactive maps at Interactive RHNA Maps. For assistance on annual reports, contact APR@hcd.ca.gov.

- *HCD Request and Time Limits*: Local governments are only required to submit an economic feasibility study upon HCD request. HCD cannot request to review an economic feasibility study for an ordinance if more than 10 years have passed since the adoption or amendment of that ordinance, whichever is later.

Examples of when the review provisions of AB 1505 apply:

- Jurisdiction adopted an inclusionary housing ordinance for both ownership and rental units in 2003. Due to the results of the *Palmer/Sixth Street Properties* case, the jurisdiction deleted the reference to rental units in the inclusionary housing ordinance. In 2019, the jurisdiction amends the inclusionary housing ordinance to reinstate its application to rental units.

- Jurisdiction adopted an inclusionary housing ordinance for both ownership and rental units in 2003. The ordinance requires on-site construction of the affordable rental units and does not provide for alternative means of compliance to the on-site requirement for rental units. In 2019, the jurisdiction amends the inclusionary

housing ordinance to include alternative means of compliance to the on-site requirement for rental units.

- Jurisdiction adopts a new inclusionary housing ordinance for rental units in 2018.

Examples of when the review provisions of AB 1505 do not apply:

- Enforcement of a preexisting ordinance: A jurisdiction with an inclusionary housing ordinance adopted in 2003 for both ownership and rental units did not enforce the inclusionary requirement for rental units due to the results of the *Palmer/Sixth Street Properties* case. Now, the jurisdiction is enforcing the inclusionary requirement for rental units without adopting or amending the ordinance.

- Reinstatement of a previously suspended ordinance: A jurisdiction with an inclusionary housing ordinance adopted in 2008 for both ownership and rental units suspended the inclusionary requirement for rental units due to the results of the *Palmer/Sixth Street Properties* case. Now, the jurisdiction is reinstating the suspended inclusionary requirement for rental units without adopting an, or amending the, inclusionary housing ordinance.

HCD REVIEW PROCESS, CRITERIA AND TIMING

Review Process

Step 1: Evaluate applicability of AB 1505 review to subject inclusionary ordinance.

Third parties can request HCD's evaluation of a jurisdiction's rental inclusionary housing ordinance by submitting a request to the HCD's accountability and enforcement email address, ComplianceReview@hcd.ca.gov. HCD may also initiate an evaluation of an inclusionary housing ordinance based on information contained within a Housing Element, Annual Progress Report, stakeholder comment letter, phone call, news article, or additional source.

Step 2: If HCD requests evidence that the ordinance does not unduly constrain the production of housing, the jurisdiction must submit an economic feasibility study to HCD within 180 days from its receipt of HCD's request. When complying with the HCD request, the jurisdiction should submit sufficient information to demonstrate how the study meets the specified criteria below.

Step 3: Upon submission of an economic feasibility study, HCD has 90 days to issue a finding as to whether or not the study meets all specified criteria. During its review, HCD may consult with any local government, agency, group, or person prior to issuance of its findings.

Specified Criteria

- A qualified entity with demonstrated expertise in the preparation of economic feasibility studies prepared the economic feasibility study.

- The study methodology followed best professional practices and was sufficiently rigorous to allow an assessment of whether the rental inclusionary requirement, in combination with other factors that influence feasibility, is economically feasible.

- If the economic feasibility study was prepared after September 15, 2017, the jurisdiction must have made it available on its website for at least 30 days. After the 30-day period expired, the study must have been placed on the agenda of a regularly scheduled meeting of the jurisdiction's legislative body for consideration and approval.

The economic feasibility study should not be confused with a "nexus study" required when a jurisdiction seeks to justify impact mitigation fees, such as commercial linkage fees, prepared pursuant to Government Code section 66000. Inclusionary requirements may be based on the existing and projected housing needs of the region and other factors reasonably related to the regional welfare. They need not be based on a demonstration of the additional need for affordable housing generated by new residential development.

If a jurisdiction fails to submit an economic feasibility study to HCD within 180 days of receiving HCD's request, or if HCD makes a final decision that the economic feasibility study does not meet the statutory requirements, the jurisdiction's rental inclusionary requirement cannot require more than 15 percent of the total number of units in a development be affordable to households at 80 percent of the area median income. The jurisdiction may continue implementing a requirement at more than 15 percent once it has submitted an economic feasibility study to HCD providing evidence that the inclusionary housing ordinance does not unduly constrain housing production, and HCD makes a finding that the study meets the statutory requirements.

APPEALS

A jurisdiction can appeal HCD's finding that the economic feasibility study does not meet the statutory requirements by submitting an appeal to the Director of HCD. Once HCD receives the appeal, it has 90 days to issue a final decision, unless the timeline is extended by a mutual agreement between the jurisdiction and HCD.

Attachment A
AB 1505 Revisions to Sections 65850, 65850.01, and Section 3

SECTION 1. Section 65850 of the Government Code is amended to read:

65850. The legislative body of any county or city may, pursuant to this chapter, adopt ordinances that do any of the following:
(a) Regulate the use of buildings, structures, and land as between industry, business, residences, open space, including agriculture, recreation, enjoyment of scenic beauty, use of natural resources, and other purposes.
(b) Regulate signs and billboards.
(c) Regulate all of the following:
(1) The location, height, bulk, number of stories, and size of buildings and structures.
(2) The size and use of lots, yards, courts, and other open spaces.
(3) The percentage of a lot which may be occupied by a building or structure.
(4) The intensity of land use.
(d) Establish requirements for off street parking and loading.
(e) Establish and maintain building setback lines.
(f) Create civic districts around civic centers, public parks, public buildings, or public grounds, and establish regulations for
those civic districts.
(g) 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 occupied by, households with incomes that do not exceed the limits for moderate income, lower income, very low income, or extremely low income households specified in Sections 50079.5, 50093, 50105, and 50106 of the Health and Safety Code. 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.

SECTION. 2.

Section 65850.01 is added to the Government Code, to read:

65850.01. *(a) The Department of Housing and Community Development, hereafter referred to as "the department" in this section, shall have the authority to review an ordinance adopted or amended by a county or city after September 15, 2017, that requires as a condition of the development of residential rental units that more than 15 percent of the total number of units rented in a development be affordable to, and occupied by, households at 80 percent or less of the area median income if either of the following apply:*
(1) The county or city has failed to meet at least 75 percent of its share of the regional housing need allocated pursuant to Sections 65584.04, 65584.05, and 65584.06, as applicable for the above-moderate income category specified in Section 50093 of the Health and Safety Code, prorated based on the length of time within the planning period pursuant to paragraph (1) of subdivision (f) of Section 65588, over at least a five-year period. This determination shall be made based on the annual housing element report submitted to the department pursuant to paragraph (2) of subdivision (a) of Section 65400.
(2) The department finds that the jurisdiction has not submitted the annual housing element report as required by paragraph (2) of subdivision (a) of Section 65400 for at least two consecutive years.

(b) Based on a finding pursuant to subdivision (a), the department may request, and the county or city shall provide, evidence that the ordinance does not unduly constrain the production of housing by submitting an economic feasibility study. The county or city shall submit the study within 180 days from receipt of the department's request. The department's review of the feasibility study shall be limited to determining whether or not the study meets the following standards:

(1) A qualified entity with demonstrated expertise preparing economic feasibility studies prepared the study.

(2) If the economic feasibility study is prepared after September 15, 2017, the county or city has made the economic feasibility study available for at least 30 days on its Internet Web site. After 30 days, the county or city shall include consideration of the economic feasibility study on the agenda for a regularly scheduled meeting of the legislative body of the county or city prior to consideration and approval. This paragraph applies when an economic feasibility study is completed at the request of the department or prepared in connection with the ordinance.

(3) The study methodology followed best professional practices and was sufficiently rigorous to allow an assessment of whether the rental inclusionary requirement, in combination with other factors that influence feasibility, is economically feasible.

(c) If the economic feasibility study requested pursuant to subdivision (b) has not been submitted to the department within 180 days, the jurisdiction shall limit any requirement to provide rental units in a development affordable to households at 80 percent of the area median income to no more than 15 percent of the total number of units in a development until an economic feasibility study has been submitted to the department and the department makes a finding that the study meets the standards specified in paragraphs (1), (3), and, if applicable, (2), of subdivision (b).

(d) (1) Within 90 days of submission, the department shall make a finding as to whether or not the economic feasibility study meets the standards specified in paragraphs (1), (3), and, if applicable, (2), of subdivision (b).

(2) If the department finds that the jurisdiction's economic feasibility study does not meet the standards in paragraphs (1), (3), and, if applicable, (2), of subdivision (b), the jurisdiction shall have the right to appeal the decision to the Director of Housing and Community Development or his or her designee. The director or his or her designee shall issue a final decision within 90 days of the department's receipt of the appeal unless extended by mutual agreement of the jurisdiction and the department.

(3) If in its final decision the department finds that jurisdiction's economic feasibility study does not meet the standards in paragraphs (1), (3), and, if applicable, (2), of subdivision (b), the jurisdiction shall limit any requirement to provide rental units in a development affordable to households at 80 percent of the area median income to no more than 15 percent of the total number of units in a development until such time as the jurisdiction submits an economic feasibility study that supports the ordinance under review and the department issues a finding that the study meets the standards in paragraphs (1), (3), and, if applicable, (2), of subdivision (b).

(e) The department shall not request to review an economic feasibility study for an ordinance more than 10 years from the date of adoption or amendment of the ordinance, whichever is later.

(f) The department shall annually report any findings made pursuant to this section to the Legislature. The report required by this subdivision shall be submitted in compliance with Section 9795.

(g) The Legislature finds and declares that ensuring access to affordable housing is a matter of statewide concern and not a municipal affair, as that term is used in Section 5 of Article XI of the California Constitution. Therefore, this section shall apply to an ordinance proposed or adopted by any city, including a charter city.

SEC. 3. *The Legislature finds and declares all of the following:*

(a) Inclusionary housing ordinances have provided quality affordable housing to over 80,000 Californians, including the production of an estimated 30,000 units of affordable housing in the last decade alone.
(b) Since the 1970s, over 170 jurisdictions have enacted inclusionary housing ordinances to meet their affordable housing needs.
(c) While many of these local programs have been in place for decades, a 2009 appellate court decision has created uncertainty and confusion for local governments regarding the use of this tool to ensure the inclusion of affordable rental units in residential developments.
(d) It is the intent of the Legislature to reaffirm the authority of local jurisdictions to include within these inclusionary housing ordinances requirements related to the provision of rental units.
(e) The Legislature declares its intent in adding subdivision (g) to Section 65850 of the Government Code, pursuant to Section 1 of this act, to supersede the holding and dicta in the court decision of Palmer/Sixth Street Properties, L.P. v. City of Los Angeles (2009) 175 Cal.App.4th 1396 to the extent that the decision conflicts with a local jurisdiction's authority to impose inclusionary housing ordinances pursuant to subdivision (g) of Section 65850 of the Government Code, as added pursuant to Section 1 of this act.
(f) In no case is it the intent of the Legislature in adding subdivision (g) to Section 65850 of the Government Code, pursuant to Section 1 of this act, to enlarge, diminish, or modify in any way the existing authority of local jurisdictions to establish, as a condition of development, inclusionary housing requirements, beyond reaffirming their applicability to rental units.
(g) This act does not modify or in any way change or affect the authority of local jurisdictions to require, as a condition of the development of residential units, that the development include a certain percentage of residential for-sale units affordable to, and occupied by, households with incomes that do not exceed the limits for moderate-income, lower income, very low income, or extremely low income households.
(h) It is the intent of the Legislature to reaffirm that existing law requires that the action of any legislative body of any city, county, or city and county to adopt a new inclusionary housing ordinance be taken openly and that their deliberations be conducted openly consistent with the requirements of the Ralph M. Brown Act (Chapter 9 (commencing with Section 54950) of Part 1 of Division 2 of Title 5 of the Government Code).
(i) Except as provided in subdivision (e), in no case is it the intent of the Legislature in adding subdivision (g) to Section 65850 of the Government Code, pursuant to Section 1 of this act, to enlarge, diminish, or modify in any way the existing rights of an owner of residential real property under Sections 1954.50 to 1954.535, inclusive, of the Civil Code and Sections 7060 to 7060.7, inclusive, of the Government Code.