A SUMMARY OF LEGAL ISSUES REGARDING COMMERCIAL LINKAGE FEES AND AFFORDABLE HOUSING IMPACT FEES

Commercial linkage fees are impact fees charged to new retail, office, hotel and other *non-residential* development to offset the impact of commercial growth on the need for affordable housing. Affordable housing impact fees are charged to new market-rate *residential* development to offset the impact of new market-rate housing on the need for affordable housing. While some commercial linkage fees have been in place for over 25 years, affordable housing impact fees are relatively new.

I. What Are Nexus Studies?

Both commercial linkage fees and affordable housing impact fees must be justified by a 'nexus study' demonstrating that the amount of the fee is justified by the impact of typical development projects on the need for affordable housing.

Commercial Linkage Fees. A nexus study for a commercial linkage fee typically looks first at the number of employees generated by different types of development and the expected wages of those workers. This data is then translated into new households created by those workers and their expected household incomes, divided into various categories: very low income, low income, moderate income, and above moderate income. For each income category, the report calculates the dollar subsidy required to construct housing affordable to those workers and translates that into a cost per square foot of commercial development.

Affordable Housing Impact Fees. A nexus study for new market-rate housing is similar. It looks at the amount of income that new residents are expected to spend on local-serving jobs (retail, personal services, health care, education, etc.) and the new jobs that will be created by those increased expenditures. Once the number and expected income of those new jobs is determined, the study determines the need for affordable housing as is done for commercial linkage fees.

The impact of new housing on the need for affordable housing is usually less than the impact of new commercial development. For instance, in one study, each 100,000 square feet of office space was found to create a need for 84 affordable units, while each 100 condominium units were found to create a need for 18 affordable units.

II. Review in the Courts

Few published cases have reviewed either commercial linkage fees or affordable housing impact fees. In *Commercial Builders of Northern California v. City of Sacramento*,[1] the Ninth Circuit Court of Appeals in 1991 found the City of Sacramento's linkage fee to be constitutional. The City had completed a detailed nexus study showing the effects of commercial development on the need for low-income housing and had adopted a fee that raised only nine percent of the cost of the needed housing.[2] The court concluded that the fee "bears a *rational relationship* to a public cost closely associated with" new development.[3]

Generally Applicable Fees v. Individual Project Fees. A fee like Sacramento's that is generally applicable to broad classes of development—offices, retail stores, apartments—need only be supported by studies showing that it is reasonably related to the impacts of new development "in the *generality* or *great majority* of cases."[4] However, if there is no set formula for calculating the fee, then the burden of proof is

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[1] 941 F.2d 872 (9th Cir. 1991), *cert. denied* 504 U.S. 931 (1992).
[2] *See id.* at 873.
[3] *Id.* at 874 (emphasis added).
[4] *San Remo Hotel v. City & County of San Francisco*, 27 Cal 4th 643, 673 (2002).

on the community to demonstrate that the fee has an "essential nexus"[5] and is "roughly proportional"[6] to the specific impact of a project on the need for affordable housing.

In-Lieu Fees v. Nexus-Based Fees. Communities with adopted inclusionary ordinances may allow the developer to pay an "in-lieu fee" if the developer does not actually construct the units. While a nexus-based fee is based on the project's impact on the need for affordable housing, an "in-lieu fee" is based on the cost to the locality of providing an affordable home if the developer does not build the home on site.. In *Calif. Building Industry Ass'n v. City of San Jose*,[7] the California Supreme Court held that no nexus study is required to justify an inclusionary requirement that allows an in-lieu fee as an alternative.

However, because of State laws involving rent control, neither an inclusionary requirement nor an in-lieu fee can be applied to *rental* housing unless the developer agrees by contract to provide affordable rental housing in exchange for a public subsidy or regulatory incentives.[8] Only a nexus-based fee can be charged to rental developments.

Amount of Fees. There are few legal constraints on the amount of fees. Nexus-based fees cannot exceed those justified by the nexus study. They must not be so high as to be confiscatory or to prevent all feasible use of the property, and housing development, in particular, must remain feasible to ensure that housing can be built as shown in a community's housing element.

In general, policy considerations are usually more important than legal considerations in determining the amount of the fees. They are often set below the maximum justified amounts because of various policy considerations, such as comparisons with other cities.

III. Adoption of Nexus-Based Fees

Ordinance and Fee Resolution. Fees may be adopted by either ordinance or resolution. Most communities choose to adopt the actual fee *amount* by resolution so that the amount of the fee can be changed more easily if conditions change.

Housing developers have the right to provide affordable housing rather than paying the fee. Consequently, in almost all cases, the fee resolution is accompanied by an ordinance. Typical provisions include:

- Authority to adopt fees by resolution;
- Establishment of a restricted fund to receive the fees;
- Appropriate use of the fees;
- The amount of affordable housing required to mitigate the impact if proposed as an alternative to paying the fee;
- Basic standards for on-site affordable housing and provisions for ensuring affordability;
- Exemptions from fee payment;
- Waiver provisions to allow a developer to challenge the ordinance as applied to his/her property.

Some communities choose to adopt the ordinance as part of their zoning ordinance, while others adopt the ordinance as part of an impact fee ordinance. Several communities have adopted very basic ordinances and have included most of the above provisions in guidelines adopted by resolution.

CEQA Status. The adopted Guidelines under the California Environmental Quality Act state that a project subject to CEQA does not include "the creation of a government funding mechanism . . . which

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[5] *Nollan v. California Coastal Commission,* 483 U.S. 825, 837 (1987).
[6] *Dolan v. City of Tigard,* 512 U.S. 374, 391 (1994).
[7] 61 Cal. 4th 435 (2015).
[8] *See Palmer/Sixth St. Props., L.P. v. City of Los Angeles,* 175 Cal. App. 4th 1396, 1410-11.

does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment."[9] Since the adoption of a fee schedule does not involve a commitment to any specific project, it is not a "project" and so is not subject to CEQA. It is irrelevant whether the fees are adopted by ordinance or resolution.

Adoption of an inclusionary ordinance usually does not involve any provisions that might require physical changes in the environment; the terms usually involve changes in the affordability of certain units, not their design. In this case, the inclusionary ordinance is often found to be exempt from CEQA under the "common sense exemption" because it can be determined with certainty "that there is no possibility that the activity in question may have a significant effect on the environment." (Guidelines Section 15061(b)(3).)

Public Notice and Hearing. If an ordinance is adopted or amended as part of the adoption of the nexus-based fees, procedures established in state law, local ordinance, or city charter regarding notice and hearing for that type of ordinance must be followed.

The fees themselves must be adopted at a public hearing held by the City Council or Board of Supervisors after notice is provided as required by Government Code Section 66018. Additionally, although fees for affordable housing have not been determined to be "fees" as defined by the Mitigation Fee Act, agencies may wish to follow the notice procedures in Government Code Section 66019. These code sections together require:

- Two published notices with at least five days separating the notices (for example, published 10 days and 4 days before the public hearing);
- Notice to anyone requesting notice at least 14 days in advance of the hearing;
- Availability of supporting information 10 days before the hearing.

The fees may not become effective until 60 days after adoption. (See http://21elements.com/Download-document/738-Hearing-Notice-Commercial-Linkage-and-Residential-Housing-Fees.html , login required, contact Josh Abrams at 510.761.6001 for login)

IV. Other Issues

Use of Fees. The justification for nexus-based fees is that new development creates new jobs, and some of those employees need affordable housing. Consequently, nexus-based fees need to be used for housing that benefits *employees*. Use of the fees for types of housing where residents may not be employed, such as emergency shelters, senior housing, and supportive housing, may not be consistent with the purpose of the fees. If communities wish to use these fees for these types of housing, a survey should be done to determine if residents are typically employed. One community found that substantial proportion of persons using its shelters were, in fact, employed in the community.

Relation to Housing Element. The Housing Element does not need to be amended due to the adoption of housing fees or an inclusionary ordinance, nor does the ordinance need to be submitted to HCD.[10] However, agencies should ensure that any fees or ordinances are consistent with the policies and programs in their Housing Elements.

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[9] CEQA Guidelines Section 15378(b)(4).

[10] *See Action Apartment Ass'n v. City of Santa Monica* (2008) 166 Cal. App. 4th 456, 471.

Relation to State Density Bonus Law. No density bonus needs to be given for payment of housing fees. Bonuses need to be given only if affordable housing is provided on-site as part of a housing development or a land donation is included that conforms to the strict requirements of the statute.

The local agency's ordinance, resolution, or guidelines should establish the amount of affordable housing that must be provided on-site to mitigate the impacts of the project. If a project provides less housing than required to mitigate the impact, even if enough to allow a density bonus, then the agency can require fees to mitigate the remaining impact, prorated to reflect the amount of on-site mitigation provided. For instance, if a density bonus project provides 5% very low income units, but 10% are required to mitigate the impact, then the agency may impose half of its usual fees.

Fee Protests. Agencies should provide notice of the applicant's ability to protest the fees in the form required by Government Code Section 66020cat the time of project approval. If no notice is given, a protest may be lodged even while the units are under construction.

V. Summary: Considerations in Adopting Nexus-Based Fees

In adopting nexus-based fees, cities and counties should consider the following:

- Establishing generally applicable fees;
- Whether to retain any existing in-lieu fees;
- Adoption of ordinance or amendment to existing ordinance, if required;
- Whether to adopt zoning ordinance or impact fee ordinance;
- Which provisions to include in an ordinance, fee resolution, or guidelines;
- CEQA status;
- Requirements for notice and hearing;
- Use of the fees;
- Consistency with Housing Element;
- Procedures for providing notice of right to protest.