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## Reflections on Inclusionary Housing and a Renewed Look at its Viability

Laura M. Padilla

California Western School of Law, [lpadilla@cwsl.edu](mailto:lpadilla@cwsl.edu)

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## REFLECTIONS ON INCLUSIONARY HOUSING AND A RENEWED LOOK AT ITS VIABILITY

*Laura M. Padilla\**

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\* Associate Professor of Law, California Western School of Law; J.D. Stanford Law School, 1987; B.A. Stanford University, 1983. I am deeply grateful to my California Western School of Law colleagues, Barbara Cox, Tom Barton and Katharine Rosenberry, for their support and comments. I also want to thank numerous research assistants from California Western School of Law for their help, especially Stacy Duffey, class of 1994, and Peggy O'Neill and David Schwartz, class of 1995.

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## I. INTRODUCTION

Inclusionary housing programs typically require that a residential home developer set aside a specified percentage of new units as very low-, low- or moderate-income housing.<sup>1</sup> These programs usually pro-

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1. The actual amounts which qualify a household as very low-, low- or moderate-income vary from region to region, but the definition tends to remain fairly constant. The Department of Housing & Urban Development ("HUD") has defined these households in the context of Section 8 housing as follows:

The term "low-income families" means those families whose incomes do not exceed 80 per centum of the median income for the area, as determined by the Secretary with adjustments for smaller and larger families, except that the Secretary may establish income ceilings higher or lower than 80 per centum of the median for the area on the basis of the Secretary's findings that such variations are necessary because of prevailing levels of construction costs or unusually high or low family incomes. The term "very low-income families" means low-income families whose incomes do not exceed 50 per centum of the median family income for the area, as determined by the Secretary.

42 U.S.C. § 1437a(b)(2) (Supp. V 1993). Elsewhere, HUD has defined moderate-income families as "families or persons whose incomes are between 80 percent and 95 percent of the

vide incentives to offset the costs of providing affordable housing. Cities and counties throughout the country have adopted inclusionary housing programs,<sup>2</sup> and California, one of the affordable housing leaders, is considering adoption of a mandatory statewide program.

The most important aspect of inclusionary housing is that it forces the production of low- and moderate-income housing at a time when there is a critical shortage of this housing. However, inclusionary housing is not problem-free. First, it puts the onus of solving a society-wide problem on a small group, namely developers. This may be unfair considering the scope and severity of the problem, and that the group primarily responsible for solving the problem is not primarily responsible for causing the problem.<sup>3</sup> Second, it may lead to a decrease in the production of housing generally, as well as the production of housing affordable to low- and moderate-income households.<sup>4</sup> Third, it poses a number of legal issues the resolution of which may undermine inclusionary housing programs. For example, inclusionary housing may be invalid as a taking or may violate the due process and equal protection clauses of the United States Constitution and individual state constitutions. Similarly, resale restrictions, which are included in many inclusionary housing programs, may be invalid restraints on alienation and violate antitrust laws.

The issues raised by inclusionary housing require a fresh review in light of changes to the United States Supreme Court and current trends favoring private property rights.<sup>5</sup> The inclusionary housing issue is also timely because California is considering adoption of a mandatory statewide inclusionary housing program,<sup>6</sup> which, if adopted, would be the first statewide program in the country. It would have such far-reaching consequences that prior to adoption of such a program, it is important to analyze issues posed by inclusionary housing, fully exploring its advantages and disadvantages.

Part II of this Article provides a background on the affordable

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median income for the area, as determined by the Secretary with adjustments for smaller and larger families." 12 U.S.C. § 4119(5) (Supp. V 1993). Some states also rely on these HUD definitions. *See, e.g.*, CAL. HEALTH & SAFETY CODE § 50105 (West 1994).

2. While some localities enact inclusionary housing programs through inclusionary housing ordinances or inclusionary zoning, others do so by incorporating them into their housing elements or other state-mandated housing requirements. Thus, for ease of reference, I will refer to all such inclusionary housing measures as "inclusionary housing programs."

3. *See infra* text accompanying note 164.

4. *See infra* text accompanying notes 218-20.

5. *See infra* text in first full paragraph following note 330.

6. *See infra* part II.D.

housing crisis, responses to the crisis, and why inclusionary housing is a crucial part of the response. It then gives a more detailed description of inclusionary housing, including representative components of inclusionary housing programs. This part concludes with an introduction of California's proposed inclusionary housing program. Part III of this Article surveys policies in support of inclusionary housing. Part IV analyzes criticisms of inclusionary housing and in the process, reveals many flaws in those criticisms. Part V discusses legal challenges to inclusionary housing programs, including challenges on the grounds that inclusionary housing constitutes a taking, violates substantive due process and equal protection, imposes invalid restraints on alienation, and violates antitrust law. The Article concludes with my thesis that most inclusionary housing programs, including California's proposed program, remain viable and are legally valid, provided the governing regulations are carefully drafted to maximize efficiency, effectiveness, and fairness.

## II. BACKGROUND

This section first provides a brief historical context to the affordable housing crisis and responses to the crisis at federal, state and local levels. It then addresses why those responses have generally been inadequate, and why they should be supplemented by inclusionary housing. It concludes with a description of inclusionary housing programs and an overview of California's proposed program.

### A. *The Affordable Housing Crisis*

Most people would agree that everyone in this country has a right to shelter meeting minimum quality standards. Federal policy promotes the "[r]ealization as soon as feasible . . . of a decent home and a suitable living environment for every American family."<sup>7</sup> It has even been suggested that there is a constitutional right to housing.<sup>8</sup> The Supreme Court, however, has not yet recognized such a right.<sup>9</sup> It

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7. Originally declared in Housing Act of 1949, ch. 338, § 2, 63 Stat. 413, *reaffirmed* in Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 1601, 82 Stat. 601 (codified as amended at 42 U.S.C. § 1441 (1988)).

8. See Frank I. Michelman, *The Advent of a Right to Housing: A Current Appraisal*, 5 HARV. C.R.-C.L. L. REV. 207 (1970) (arguing that the right to housing is a fundamental constitutional right and positing that legislative classifications relating to low-income housing were suspect, thus subjecting them to the heightened strict scrutiny standard reserved for suspect classifications).

9. *Lindsey v. Normet*, 405 U.S. 56, 74 (1972); *James v. Valtierra*, 402 U.S. 137, 143

has stated that “[w]e are unable to perceive . . . any constitutional guarantee of access to dwellings of a particular quality. . . . Absent constitutional mandate, the assurance[s] of adequate housing . . . are legislative, not judicial, functions.”<sup>10</sup> Most state courts have also refused to recognize housing as a fundamental right.<sup>11</sup> However, at least one state court has determined that municipalities within its jurisdiction are obligated to provide developers an opportunity to build affordable housing.<sup>12</sup> Admittedly, *Mount Laurel II* and *Mount Laurel I* do not guarantee that affordable housing will be built. They do, however, remove a hurdle by providing that municipalities in growth areas have a constitutional obligation to provide a realistic opportunity for development of housing for low- and moderate-income families in their regions through land use regulations.<sup>13</sup>

In spite of judicial refusal to recognize a right to decent quality housing meeting threshold affordability standards—and perhaps because of such refusal—there is an affordable housing crisis in this country.<sup>14</sup> While it has long been recognized that low-income fami-

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(1971) (upholding statute which provides that no low-rent housing can be developed by a state public body until such project is approved by a majority vote).

10. *Lindsey*, 405 U.S. at 74.

11. *Adams v. Superior Ct.*, 524 P.2d 375, 379 (Cal. 1974) (holding that adequate housing is not so fundamental a right as to invoke the strict scrutiny standard under the equal protection clause of the Constitution); *McQueen v. National Capital Housing Auth.*, 366 A.2d 786, 797 (D.C. 1976); *Collins v. AAA Homebuilders, Inc.*, 333 S.E.2d 792, 794 (W. Va. 1985). But, some state legislatures have countered by providing statutory authority for the provision of housing to all of their residents. For example, “[t]he availability of housing is of vital statewide importance, and the early attainment of decent housing and a suitable living environment for every California family is a priority of the highest order.” CAL. GOV’T CODE § 65580(a) (West 1994); see also N.J. STAT. ANN. § 55:13C-1(c) (West 1994) (“It is a matter of urgent public concern that safe and habitable shelter be available at all times to all residents of this State.”).

12. *Southern Burlington County NAACP v. Township of Mount Laurel*, 456 A.2d 390, 415 (N.J. 1983) [hereinafter *Mount Laurel II*] (imposing an affirmative obligation on many municipalities to use government subsidies together with other zoning techniques to provide incentives which would assure the development of affordable housing); *Southern Burlington County NAACP v. Township of Mount Laurel*, 336 A.2d 713, 724 (N.J. 1975) [hereinafter *Mount Laurel I*].

13. *Mount Laurel II*, 456 A.2d at 415; *Mount Laurel I*, 336 A.2d at 724.

14. See generally CAL. GOV’T CODE § 65913 (West 1994) (“[T]here exists a severe shortage of affordable housing, especially for persons and families of low and moderate income.”); ALAN MALLACH, INCLUSIONARY HOUSING PROGRAMS: POLICIES AND PRACTICES 4 (1984) (“Studies and publications on the subject of housing appeared in which the word ‘crisis’ became more and more prominent.”); Paul K. Stockman, Note, *Anti-Snob Zoning in Massachusetts: Assessing One Attempt at Opening the Suburbs to Affordable Housing*, 78 VA. L. REV. 535 (1992). The California legislature’s findings in its proposed inclusionary housing program state that “[m]any lower income renters in California are paying 50 percent or more

lies have not been able to purchase housing, in recent decades, many middle-income families have also been unable to do so.<sup>15</sup>

A recent publication reports that in California, "[o]nly 16% of the state's low-income housing goals have been produced during the most recent housing element cycles through December 31, 1989."<sup>16</sup> Even more startling was the report's finding that "[a]lmost one quarter (24%) of all California communities are producing *no* low income housing."<sup>17</sup> Other states are experiencing similar housing shortages for low-income families.<sup>18</sup>

There are many reasons for the affordable housing crisis. Housing costs have escalated. From 1970 to 1980, the cost of a new home nearly tripled and the cost of an existing home more than doubled.<sup>19</sup> The rise in home costs results from several factors: first, the scarcity and resultant high cost of raw land and materials; second, the high demand for housing; and third, the increased regulation of the building industry.<sup>20</sup> For example, existing permit processes, slow-growth policies and land use regulations, including low density, open space and environmental requirements, high site preparation costs, subdivision fees, infrastructure costs, and other general and specific fees imposed by local governments, add significant costs to the production of new housing.<sup>21</sup> Many of these regulations are enacted as a result

of their family income for housing. Twenty percent of renters live in overcrowded or unsafe housing. For at least 250,000 Californians each year, home will be in cars, open fields, city parks, and the streets." A.B. 1684, 55th Sess. § 1 (Cal. Reg. Sess. 1993) (at proposed § 65853.5(a)(2)) [hereinafter Proposed MIHO] (which proposal would amend the California Government Code). *Contra* Peter D. Salins, *Toward a Permanent Housing Problem*, 85 PUB. INTEREST 22 (1986).

15. MALLACH, *supra* note 14, at 9 ("In essence, the household that in 1965 had a choice of housing from among the substantial majority of new units on the market, was limited to a relatively small number by 1978, and was more or less completely locked out of the market by 1981.").

16. CALIFORNIA COALITION FOR RURAL HOUSING, LOCAL PROGRESS IN MEETING THE LOW INCOME HOUSING CHALLENGE 1 (1990).

17. *Id.*

18. *See, e.g.*, N.Y. PRIV. HOUS. FIN. LAW § 1106 (McKinney 1991) ("[T]here is a serious shortage of decent affordable housing in the state for persons of low income.").

19. R. ALLEN HAYS, THE FEDERAL GOVERNMENT AND URBAN HOUSING 58-77 (1985).

20. *Id.* at 63; *see also* MALLACH, *supra* note 14, at 9; Gregory M. Fox & Barbara Rosenfeld Davis, *Density Bonus Zoning to Provide Low and Moderate Cost Housing*, 3 HASTINGS CONST. L.Q. 1015, 1017-19 (1976); Stockman, *supra* note 14, at 536.

21. *See generally* ADVISORY COMMISSION ON REGULATORY BARRIERS TO AFFORDABLE HOUSING, "NOT IN MY BACK YARD" REMOVING BARRIERS TO AFFORDABLE HOUSING (1991) [hereinafter NIMBY REPORT]. There is no question that regulation significantly increases the cost of new housing. "Although costs vary widely, the Commission has seen evidence that increases of 20 to 35 percent in housing prices attributable to excessive regulation are not

of pressure by slow-growth advocates and others concerned with maintaining property values. This public sentiment translates into defeat of affordable housing measures arising from the "Not In My Back Yard" ("NIMBY") syndrome.

In addition, many states have legislation which deters the construction of affordable housing. For example, the California State Constitution requires voters to approve new construction of low-income housing which is at least fifty percent publicly financed.<sup>22</sup> While many residents believe that more affordable housing should be developed, they do not want it in their neighborhoods. In California, residents can and do prevent construction of low-income housing by voting down proposed affordable housing projects pursuant to the referendum authority. As another example, a Florida statute dealing with affordable housing incentives, by its nature, makes it difficult to approve such incentives. It provides that "[t]he approval by the advisory committee of its affordable housing incentive recommendations must be made by affirmative vote of a majority of the membership of the advisory committee taken at a public hearing."<sup>23</sup> The statute also sets forth rigorous public hearing requirements.<sup>24</sup>

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uncommon in the most severely affected areas of the country." *Id.* at 1-1. The NIMBY Report also discusses the effect of slow-growth measures on affordable housing, particularly in California, noting that "by the end of 1988, 907 local growth-control or management measures had been enacted in the State to slow development." *Id.* at 2-2 (citation omitted).

22. CAL. CONST. art. XXXIV, § 1. This article provides in part:

No low-rent housing project shall hereafter be developed, constructed, or acquired in any manner by any state public body until, a majority of the qualified electors of the city, town or county, as the case may be, in which it is proposed to develop, construct, or acquire the same, voting upon such issue, approve such project by voting in favor thereof at an election to be held for that purpose, or at any general or special election.

*Id.* This ordinance was challenged as "unconstitutional discrimination because it hampers persons desiring public housing from achieving their objective when no such roadblock faces other groups seeking to influence other public decisions to their advantage." *James v. Valtierra*, 402 U.S. 137, 142 (1971). The challenge was unsuccessful partly because the ordinance was found to be neutral on its face and not aimed at racial minorities, only at low-rent housing projects. *Id.* at 141-42. On November 2, 1993, California residents had the opportunity to significantly weaken this constitutional article. They declined by voting in convincing numbers not to approve Proposition 168 (40% of voters voted for the change and 60% opposed it). See March Fong Eu, California Secretary of State, Statement of Vote, Nov. 2, 1993. The proposed amendment would have removed the requirement that *all* affordable housing projects be put to a vote, instead requiring voter approval only on projects in which a minimum of ten percent of the voters in the community where the project is located have signed a petition to put project approval on the ballot.

23. FL. STAT. ANN. § 420.9076(5) (West 1993).

24. *Id.*



Starting in the late 1970s and continuing through the early 1990s, the Consumer Price Index ("CPI") for housing costs rose at a much faster pace than income.<sup>25</sup> This rapid increase in housing costs disproportionately impacts very low-, low-, and moderate-income households.<sup>26</sup> Aggravating this is a decreased supply of affordable housing for low- and moderate-income households because of factors such as condominium conversion, loss of government-assisted units, abandonment of run-down housing, urban redevelopment, and rental property's tarnished investment desirability as a result of the 1986 Tax Reform Act.<sup>27</sup>

### B. Responses to the Crisis

Having set forth the existence and extent of the affordable housing crisis, it is now appropriate to look at various responses to the crisis in order to establish that even if they are somewhat effective, by themselves, they are inadequate. While it is beyond the scope of this Article to detail the history of federal responses to the affordable housing problem, it is important to briefly discuss federal policy relating to affordable housing.<sup>28</sup>

Federal housing policy expanded in the 1930s in response to the Great Depression. Since then, Congress has approved various acts involving public housing.<sup>29</sup> For example, the Housing Act of 1937

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25. HAYS, *supra* note 19, at 59; MALLACH, *supra* note 14, at 9.

26. "It is not unusual for moderate- and lower-income families to pay 35% percent or more of income for shelter, and if very low-income families are to live in standard housing without benefit of subsidy, they may pay up to 50% of income on shelter." CHARLES E. DAYE ET AL., HOUSING AND COMMUNITY DEVELOPMENT 112 (2d ed. 1989); Stockman, *supra* note 14, at 536 ("Nearly half of the poorest quartile of renters devoted over half of their income to rent; almost 27% paid more than three-quarters of their income for housing."). The NIMBY Report noted that "[t]he rise in housing costs has hurt lower income renter families, particularly in the West." NIMBY REPORT, *supra* note 21, at 1-5. Compare with HAYS, *supra* note 19, at 60, 62 (While Hays thought that low-income renters were disproportionately impacted by increased housing costs, he noted that with respect to low-income buyers, "the percentage of income paid for housing by homeowners as a group stayed relatively constant."); Richard F. Muth, *Redistribution of Income Through Regulation in Housing*, 32 EMORY L.J. 691, 693 (1983) ("Proper interpretation of the evidence strongly suggests that the fraction of income spent on housing is roughly constant throughout the income range.").

27. HAYS, *supra* note 19, at 58; see also Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) (codified at I.R.C. §§ 163, 469 (1988)).

28. For a general discussion of twentieth century federal housing policy, see DAYE ET AL., *supra* note 26; HAYS, *supra* note 19, at 58-77; Lawrence M. Friedman, *Public Housing and the Poor: An Overview*, 54 CAL. L. REV. 642 (1966) [hereinafter Friedman, *Public Housing*].

29. See, e.g., National Housing Act of 1934, ch. 847, 48 Stat. 1246 (1934) (codified in

established a public housing program.<sup>30</sup> The government generally finances public housing, but it is actually administered by local housing officials.<sup>31</sup> While various agencies have built a substantial number of units under public housing programs,<sup>32</sup> such programs have generally been considered unsuccessful as a general solution to the affordable housing crisis for a number of reasons.<sup>33</sup> First, public housing programs suffer from the stigma associated with "government-provided housing."<sup>34</sup> Second, the programs cluster low-income residents together, frequently resulting in racial as well as economic homogeneity.<sup>35</sup> Third, public housing is usually located in inner cities, typically offering inferior educational and employment opportunities. Lastly, such housing is frequently a crime magnet where many residents do not feel safe.<sup>36</sup> These programs do, however, provide housing that might not otherwise be available for low- and very low-income households.<sup>37</sup>

The government has also provided, and continues to provide, direct and indirect subsidies to developers, landlords and very low-, low-, and moderate-income households.<sup>38</sup> In addition, the federal

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12 U.S.C. §§ 1701-15 (1988 & Supp. V 1993)); Housing Act of 1949, ch. 338, 63 Stat. 413 (1949) (codified at 42 U.S.C. § 1441 (1988 & Supp. V 1993)); Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (1974) (codified at 42 U.S.C. §§ 5301-20 (1988 & Supp. V 1993)).

30. United States Housing Act of 1937, ch. 896, 50 Stat. 888 (1937) (codified as amended at 42 U.S.C. §§ 1437-37w (1988 & Supp. V 1993)).

31. HAYS, *supra* note 19, at 90; Fox & Davis, *supra* note 20, at 1018. See generally Friedman, *Public Housing*, *supra* note 28.

32. A 1995 publication stated that "[a]pproximately 1.3 million households live in public housing developments." DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, HUD REINVENTION: FROM BLUEPRINT TO ACTION 33 (1995).

33. See generally LAWRENCE M. FRIEDMAN, GOVERNMENT AND SLUM HOUSING (1968); EUGENE J. MEEHAN, PUBLIC HOUSING POLICY: CONVENTION VERSUS REALITY 169-70 (1975).

34. HAYS, *supra* note 19, at 90-91.

35. See, e.g., SEGREGATION IN RESIDENTIAL AREAS 122 (A. Hawley & V. Rock eds., 1973) [hereinafter SEGREGATION] ("Partly because the initial purpose [of public housing] was interlocked with slum clearance and partly because the projects tended to be built in areas already inhabited by the poor, the projects came to be associated with run-down areas, with the poor, and increasingly, with black or other minority occupants."); Bruce L. Ackerman, *Integration for Subsidized Housing and the Question of Racial Occupancy Controls*, 26 STAN. L. REV. 245, 292 n.226 (1974) ("For example, as of February 1969, virtually all Chicago public housing projects were located in black areas, and approximately 11,700 black persons were on the waiting list for these housing projects.").

36. HAYS, *supra* note 19, at 91; MEEHAN, *supra* note 33, at 169.

37. HAYS, *supra* note 19, at 91-92, 258.

38. There are far too many programs to describe in this Article, but some sample subsidy programs include the Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (1974) (As originally enacted, the National Housing Act Section 8 program

government administers a number of financing programs.<sup>39</sup> Finally, it provides affordable housing through rehabilitation of existing housing.<sup>40</sup>

While the federal government has responded to the affordable housing crisis through the development and administration of many programs such as those discussed above, the crisis has not been resolved through such programs, only somewhat ameliorated.

At a state level, the response to the affordable housing crisis is varied. The state responses would provide material for an entire text. I will thus focus on California because it is a leader in the affordable housing arena and is currently very active in the area of inclusionary housing.

The California legislature has enacted various laws and statutes affecting affordable housing. For example, it has declared that "[t]he provision of housing affordable to low- and moderate-income households requires the cooperation of all levels of government."<sup>41</sup> To assure that cooperation, each local government must prepare a general plan which contains, among other things, a housing element section.<sup>42</sup> A housing element consists of three general components:

- (a) An assessment of housing needs and an inventory of resources and constraints relevant to the meeting of these needs. . . .
- (b) A statement of . . . goals, quantified objectives, and policies

consisted of discrete programs focusing on new construction, substantial rehabilitation, moderate rehabilitation, and existing housing. The first two programs were repealed in 1983, and the third program was substantially cut back at the same time. The focus then shifted to existing housing with particular emphasis on a voucher program.); National Housing Act, ch. 847, § 235, 48 Stat. 1246, *repealed by* Housing and Community Development Act of 1987, Pub. L. No. 100-242, § 401(d), 101 Stat. 1815, 1899 (1988) (terminating a homeowner subsidy program created by Pub. L. No. 90-448, § 101(a), 82 Stat. 476, 477 (1968)).

39. Again, there are too many programs to include an exhaustive list. Some sample programs include the National Housing Act, ch. 847, 48 Stat. 1246; Housing Act of 1954, ch. 649, 68 Stat. 590 (codified in scattered sections of 12, 18, 20, 31, 38, 40, 42 and 48 U.S.C. (1988 & Supp. V 1993)); Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (codified in scattered sections of 5, 12, 15, 18, 20, 31, 38, 40, 42, and 49 U.S.C. (1988 & Supp. V 1993)); Housing Act of 1961, Pub. L. No. 87-70, § 101(a), 75 Stat. 149, 150 (1961) (codified as amended at 12 U.S.C. § 1715 (1988)).

40. Rehabilitation of housing is a lengthy topic beyond the purview of this Article. Some representative programs include the Housing Act of 1964, Pub. L. No. 88-560, § 312, 78 Stat. 769, 790 (1964) (codified at 42 U.S.C. § 1452b (1988 & Supp. V 1993)); Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633, 662 (1974) (codified at 42 U.S.C. §§ 1437f, 5301-20 (1988 & Supp. V 1993)). Public and private forces are both involved in the rehabilitation of existing housing.

41. CAL. GOV'T CODE § 65580(c) (West 1994).

42. CAL. GOV'T CODE § 65302(c) (West 1994).

relative to the maintenance, preservation, improvement, and development of housing. . . .

(c) A program which sets forth a five-year schedule of actions the local government is undertaking or intends to undertake to implement the policies and achieve the goals and objectives of the housing element . . . In order to make adequate provision for the housing needs of *all* economic segments of the community, the program shall do all of the following . . . (2) Assist in the development of adequate housing to meet the needs of low- and moderate-income households. . . .<sup>43</sup>

Many California cities and counties have complied in part with the housing element requirements by providing both an assessment of housing needs for all income segments of the population, and policies to maintain, improve, and develop affordable housing. Several, however, have failed to address or identify how they plan to implement those policies.<sup>44</sup> This is problematic because there are no penalties or means of enforcing compliance with proposals set forth in a housing element. Thus, there is no mechanism to ensure that a city or county is actually providing its fair share of affordable housing. At most, an interested party can bring an action against a city or county to ensure that the housing element is in conformity with the provisions of the applicable government code sections.<sup>45</sup>

There is presently no state law mandating the provision of affordable housing.<sup>46</sup> However, if developers propose projects for housing affordable to low- and moderate-income households, local governments must approve those projects without imposing additional conditions that would render the projects infeasible.<sup>47</sup> Thus, the local gov-

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43. CAL. GOV'T CODE § 65583(a)-(c) (West 1994) (emphasis added). Note, however, that the housing element does not require the production of affordable housing. It simply requires a plan explaining how affordable housing *could* be produced. Note further that it does not specify how a government program should assist in the development of affordable housing.

44. A majority of California cities do not comply with state housing element requirements. "Only about a quarter of California communities now have housing plans that meet the state regulations." Michael McCabe, *Outcry in Tony Towns Over Low-Income Homes*, S.F. CHRON., Aug. 23, 1993, at 17.

45. CAL. GOV'T CODE § 65587(b) (West 1994). However, there is a rebuttable presumption that a housing element or amendment thereto is valid if such element or amendment is determined to comply with the requirements of article 10.6 of the Government Code. CAL. GOV'T CODE § 65589.3 (West 1994).

46. Each city or county must set forth a plan for providing and maintaining housing for all income groups, but it need not execute that plan. See *supra* note 43 and accompanying text.

47. CAL. GOV'T CODE § 65589.5(b) (West 1994) (provided that the proposed project

ernment can disapprove such proposed projects only on specific, limited grounds.<sup>48</sup>

In addition to the above laws, there are various state measures designed to alleviate the affordable housing crisis. These include laws providing density bonuses and other incentives to developers who construct units for low- and moderate-income households.<sup>49</sup> Density bonuses allow a developer to exceed density limits in exchange for the provision of housing affordable to qualified residents.<sup>50</sup> This is justified because any lost profits resulting from the provision of housing at below market rates will be offset by income from extra units allowed by the density bonus.

Finally, State Assembly Bill 1684, which would establish the mixed-income housing opportunities ("MIHO") policy, was recently introduced.<sup>51</sup> If enacted, the Proposed MIHO would require all local governments to have an inclusionary housing program in place by a given date. Otherwise, a state model ordinance would become effective in any localities without such a program.<sup>52</sup> Thus, any new development would require a developer to provide affordable housing or the means to produce affordable housing. For example, if it was not feasible to produce affordable housing, a developer could instead provide fees or raw land to be used for affordable housing. I will discuss the Proposed MIHO in more detail in part D of this section, below.

As of January 1992, in California alone, at least fifty two counties and cities had inclusionary housing programs.<sup>53</sup> Just prior to that, at least twelve other jurisdictions were considering implementing new programs or strengthening existing programs.<sup>54</sup> Cities and counties in states such as Massachusetts and Maryland also have adopted

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complies with certain stated conditions).

48. *Id.*

49. *See, e.g.*, CAL. GOV'T CODE § 65915 (West 1994). Normally, a locality will be required to offer some incentives, including density bonuses, to developers who set aside a minimum percentage of units in a proposed development for low- and very low-income households. *Id.* The percentage varies depending on the composition of the targeted residents. *Id.*

50. *Id.*

51. Proposed MIHO, *supra* note 14.

52. *Id.* § 65853.7(b)-(c). The statute would allow either an existing program subject to approval, a new program subject to approval, or the state's model ordinance.

53. *Id.* § 65853.5(b)(3).

54. SAN DIEGO HOUSING COMM'N, CALIFORNIA INCLUSIONARY HOUSING SURVEY (1992) [hereinafter CA IH SURVEY].

inclusionary housing programs.<sup>55</sup> Thus, from the federal government to local governments across the country, there is a wide-spread recognition of the affordable housing crisis, the need to resolve the crisis, and the advantages of solving it through inclusionary housing.

### C. A Specific Response to the Crisis: Inclusionary Housing

Inclusionary housing programs have become a more common solution to the affordable housing crisis. State legislation typically authorizes local governments to enact zoning laws affecting housing.<sup>56</sup> Inclusionary housing programs are generally enacted pursuant to a locality's zoning powers and are typically effectuated through inclusionary zoning ordinances, policy statements, or a locality's housing element.

Inclusionary housing programs have been in effect since the early 1970s<sup>57</sup> and are still being formulated.<sup>58</sup> Every program has its own

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55. See, e.g., MASS. GEN. LAWS ANN. ch. 40B, §§ 20-23 (West 1993) (The Massachusetts Low and Moderate Income Housing Act; while this is not a true inclusionary housing program as it does not condition development approval on the provision of low- and moderate-income housing, it reduces exclusionary practices.); MONTGOMERY COUNTY, MD., CODE ch. 25A-1 (1988) (Maryland's Moderately Priced Dwelling Unit Ordinance).

56. Most states have enabling acts, many of which are modeled on a standard act. See U.S. DEP'T OF COMMERCE, STANDARD STATE ZONING ENABLING ACT (1926). Note, however, that a Fairfax County, Virginia inclusionary housing program was found invalid because it was not authorized under Virginia's state enabling act. *Board of Supervisors v. DeGroff Enter., Inc.*, 198 S.E.2d 600, 602 (Va. 1973). The *DeGroff* court went further by stating that even if proper enabling legislation were in effect, the housing program would have been a taking without just compensation and therefore invalid. *Id.* at 602. Many commentators have criticized the *DeGroff* decision. For a general discussion of courts' reluctance to follow *DeGroff*, see MALLACH, *supra* note 14, at 29-30. Authorization to enact zoning laws also arises through the police power which justifies government action if it promotes and preserves health, safety, and welfare. See *Euclid v. Ambler Realty Co.*, 272 U.S. 365, 383 (1926); *Miller v. Board of Public Works*, 234 P. 381, 383 (Cal. 1925).

57. See the Below Market Rate ("BMR") Program in Palo Alto, which was (and continues to be) administered by the Palo Alto Housing Corporation, an independent non-profit corporation, pursuant to a contract between the corporation and the city of Palo Alto. Palo Alto, Cal., Resolution 4725 (Apr. 2, 1973) (as originally enacted).

58. San Diego is currently considering adopting a program which it direly needs. "A city staff report concludes that there are 75,000 people in need of low-income housing in San Diego and 34,000 who pay more than 50 percent of their income for rent." Thor Biberman, *Council Oks Program to Help Poor Obtain Housing*, SAN DIEGO DAILY TRANSCRIPT, Jan. 27, 1993, at B1. San Diego's proposed program as drafted is based on recommendations made by the San Diego Inclusionary Housing Task Force in July 1992. The San Diego City Council approved the proposal in concept on January 26, 1993, which proposal was also lukewarmly approved by the local building association. However, when it came up for vote on November 9, 1993, it was instead tabled until 1994, when three new council members took office. It was tabled in part because the building association wanted time to author a

defined terms and parameters. Some programs in California are voluntary, but an overwhelming majority are mandatory.<sup>59</sup> Voluntary programs typically provide that a developer may set aside a suggested percentage of inclusionary units<sup>60</sup> in exchange for various incentives.<sup>61</sup> Mandatory programs require that a developer set aside a certain percentage of inclusionary units as a condition to approval of the developer's project.<sup>62</sup> The percentage of inclusionary units is dependent on various factors, including whether the unit is a rental unit or for-sale, and whether it is intended for very low-, low-, or moderate-income households. The requisite set-aside percentage varies from as few as six percent,<sup>63</sup> to as many as thirty-five percent,<sup>64</sup> but fifteen percent is about average.<sup>65</sup> Some inclusionary housing programs apply to all new developments within a locality, including development of a single home.<sup>66</sup> Many programs, however, apply only to projects containing a minimum number of units, ranging from two<sup>67</sup> to fifty.<sup>68</sup>

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new proposal. It objected to the mandatory nature of the ordinance which would have required that five percent of the units in rental projects and ten percent of the units in for-sale projects be affordable to low- and moderate-income households. The building association prefers a voluntary approach to inclusionary housing. See Lori Weisberg, *Affordable Housing Plan Postponed*, SAN DIEGO UNION-TRIB., Nov. 10, 1993, at B3. Most parties indicate that they want a consensus and are willing to take more time to find an approach that is palatable to both developers and housing advocates. *Id.*

59. At the time that the San Diego Inclusionary Housing Task Force prepared its California Inclusionary Housing Survey, of the fifty two cities and counties included in the survey which had some type of inclusionary housing program, only three counties and two cities had voluntary programs. CA IH SURVEY, *supra* note 54, at 1-4.

60. While different programs label units for very low-, low-, and moderate-income families differently, ranging from "below market rate unit," to "affordable unit," to "inclusionary unit," for ease of reference, I will label these "inclusionary units."

61. See, e.g., Orange County, Cal., Resolution 83-184 (Feb. 1, 1983) (Note, however, that Orange County initially adopted a mandatory inclusionary zoning ordinance in 1979, which was amended in 1983 to phase out the mandatory program in favor of a voluntary program.).

62. See, e.g., BERKELEY, CAL., MUN. CODE, ch. 15B.5 (1987); Davis, Cal., Ordinance 1567 (June 20, 1990).

63. See, e.g., VISTA, CAL., ORDINANCES ch. 18.34, § 18.34.120 (1993).

64. The city of Davis requires that twenty-five percent of new rental housing in developments of twenty or more units be affordable to low-income and very low-income households. Davis, Cal., Draft Housing Element Update 116 (Dec. 15, 1993).

65. See, e.g., Agoura Hills, Cal., Ordinance 137 (Sept. 23, 1987); Monterey, Cal., Ordinance 2416 (July 8, 1981), amended by Resolution 82-10 (Jan. 19, 1982) and by Ordinance 3121A (Mar. 16, 1993); SANTA CRUZ, CAL., MUN. CODE ORDINANCE 93-09, ch. 24.16, § 24.16.010 (1993).

66. See, e.g., CARLSBAD, CAL., MUN. CODE ch. 21.85, § 21.85.050 (1993).

67. See, e.g., CORONADO, CAL., MUN. CODE § 82.21.020 (1993).

68. See, e.g., City of Chula Vista, Housing Element of 1991 III-15 (Feb. 26, 1992)

Common incentives under both mandatory and voluntary programs include density bonuses, subsidies, development fee credits, streamlined permit processing, and waiver or leniency in enforcement of development standards.<sup>69</sup> In addition, local governments may offer tax exempt bond financing, or may work with developers to obtain tax exempt bond financing, tax credits, or abatement from other entities such as federal and state agencies.<sup>70</sup>

Most programs allow a developer to satisfy the housing production requirements in a number of ways. The first choice is always on-site production of inclusionary units, but developers may sometimes provide inclusionary units off-site.<sup>71</sup> Another option for developers is to pay a fee to either the regulating government, a housing trust fund, or a stated agency, in-lieu of building the requisite number of inclusionary units. The funds are typically earmarked for the production of inclusionary units.<sup>72</sup> Developers may also buy credits from other developers who have exceeded the minimum inclusionary requirements.<sup>73</sup> Finally, they may donate land within an appropriate zone, such land to be used for the production of affordable housing by another agency or developer (i.e., an agency which receives fees in-lieu of units).<sup>74</sup>

Many inclusionary housing programs require that inclusionary units be dispersed throughout a development rather than clustered, and that the exterior design be consistent with the design of non-inclusionary units.<sup>75</sup> However, many codes do allow a developer to

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(adopted by the City Council under Resolution No. 16532).

69. See, e.g., Monterey, Cal., Ordinance 2416 (July 8, 1981) (includes non-general fund subsidies, mortgage revenue bonds, waivers, or density increases).

70. *Id.*

71. At least 32 programs in California allow off-site production of a portion of the inclusionary units. CA IH SURVEY, *supra* note 54, at 5.

72. Most inclusionary housing programs in California allow in-lieu fees, especially if a fraction of an affordable unit would otherwise be required or it is simply not financially feasible to build inclusionary units in the area of development (i.e., because the project is too small or is in an area of exceptionally high land values). *Id.* However, some of these programs have collected a substantial amount of fees and have yet to produce a single housing unit. See *infra* notes 236-38 and accompanying text.

73. See, e.g., Orange County, Cal., Resolution 89-961, Attachment "A," H-D-4 to 5 (June 21, 1989); SANTA CRUZ, CAL., MUN. CODE ORDINANCE 91-45, ch. 24.16, § 24.16.030 (1985).

74. See, e.g., Monterey, Cal., Resolution 82-16 (Jan. 19, 1982).

75. For example, one code provides:

Inclusionary units should be reasonably dispersed throughout the development, should contain on the average the same number of bedrooms as the market rate units in the development, and should be compatible with the design and use of



alter the level and quantity of interior design features in order to make the production of such units more cost efficient.<sup>76</sup>

Other common requirements of inclusionary housing programs are that the units be built concurrently with, or prior to, market rate units, and that each development phase of a project include a proportional number of inclusionary units.<sup>77</sup>

Qualification requirements for initial occupants of inclusionary units vary from program to program, but are always tied to income (which is generally modified based on family size according to HUD guidelines), and are usually adjusted for inflation on an annual basis.<sup>78</sup> The easiest, and perhaps most common way to choose occupants from qualifying renters or buyers is to simply hold a lottery.<sup>79</sup> Programs also look to other factors in prioritizing applicants, such as family size, whether applicants are employees of, or work within, the locality supervising the program, and how long the applicants have resided in the regulating locality.<sup>80</sup> Even with high priority applicants, demand often exceeds supply, so a lottery is still necessary.<sup>81</sup>

In order to keep inclusionary units affordable, most programs have resale or rental restrictions.<sup>82</sup> Surprisingly, a number of programs in California have no mechanisms in place for preserving affordability.<sup>83</sup>

Resale or rental restrictions are most commonly established through covenants, deed restrictions, wrap around financing, land sales

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remaining units in terms of appearance, materials, and finished quality. The applicant shall have the option of reducing the interior amenity level and square footage of inclusionary units, provided all units conform to the requirements of the City Building and Housing Codes.

SANTA CRUZ, CAL., MUN. CODE ORDINANCE 91-45, § 1 (1993) (amending § 24.16.010(2) of ch. 24.16 of Title 24 of the Municipal Code).

76. *Id.*

77. *Id.*; see also Proposed MIHO, *supra* note 14, § 65853.7(a)(8); Carlsbad, Cal., Ordinance NS-232, at 21.85.120 (Apr. 20, 1993).

78. See, e.g., Irvine, Cal., Resolution 93-68 (May 25, 1993) ("[M]onthly rents shall be determined by . . . current HUD rent level for Orange County based on unit size, household size and income levels.").

79. See, e.g., Monterey, Cal., Resolution 90-12 (Jan. 16, 1990).

80. See, e.g., BERKELEY, CAL., MUN. CODE ch. 15B (1987); Irvine, Cal., Resolution 89-161 (Nov. 28, 1989); City of Palo Alto, Amended Below Market Rate (BMR) Rental Guidelines, section II(2) (June 26, 1988).

81. See Monterey, Cal., Resolution 90-12 (Jan. 16, 1990).

82. See, e.g., BERKELEY, CAL., MUN. CODE ch. 15B (1987); Irvine, Cal., Resolution 89-161 (Nov. 28, 1989); City of Palo Alto, Amended Below Market Rate (BMR) Rental Guidelines, section II(2) (June 26, 1988).

83. CA IH SURVEY, *supra* note 54, at 1-4.

contracts, options, and first rights of refusal.<sup>84</sup> Some of these restrictions have been described as follows:

1. *Deed Restrictions*: A developer may record a restriction against a property in the deed. This binds the buyer and all later buyers to sell only to low to moderate income families.
2. *Wrap-around Financing*: A developer records a subordinate mortgage against a property. This does not come due unless the home is sold. When sold, a portion of the equity is returned to the moderate income housing program to subsidize some other home. This work[s] as a deterrent to speculation by the buyer and has other administrative advantages.
3. *Land Sale Contracts*: The developer sells a home to a buyer under contract of sale. The home only transfers title when the buyer has lived in the home for a specific period, say, five or ten years. This deters speculation by buyers.
4. *First Right of Refusal*: The developer records "first right of refusal" in favor of the City for a property, at a pre-stipulated price. When the home comes up for sale, the City has the option of immediately buying the home or of letting the owner sell it on the open market. If the City buys the home it then sells the home at that price to another low to moderate income buyer.<sup>85</sup>

Most resale restrictions set a minimum term of affordability, ranging from five years<sup>86</sup> to infinite duration.<sup>87</sup>

The nature of a resale restriction is two-fold. First, the amount of equity appreciation is limited in order to preserve the affordable nature of the unit for future purchasers. Price restrictions vary and resale pricing formulas can be very complex. Simplified, a sales price is typically limited to the sum of: the seller's purchase price; annual appreciation tied to a readily identifiable measure such as the consumer price index ("CPI"), inflation or median local appreciation; the

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84. See, e.g., Monterey, Cal., Resolution 82-16 (Jan. 19, 1982), amended by Ordinance 3121A (Mar. 16, 1993).

85. City of Monterey, Developer's Guide to the Moderate Income Housing Ordinance No. 2416 as Amended ¶ F (1993) [hereinafter Monterey, Developer's Guide].

86. See, e.g., Sacramento, Cal., City Council Resolution 91-731 (Sept. 17, 1991) (Sacramento's program has a five year restriction but also stipulates that if a home were sold within five years of the initial purchase, a portion of the appreciation would be paid to a fund to reduce costs for future low- or moderate-income home buyers. This is a blend between a deed restriction and a recapture program.) For a discussion of recapture programs, see *infra* text accompanying notes 93-95.

87. Many programs in California have some sort of permanent affordability restrictions. For example, the Davis program requires that certain units be maintained in perpetuity as inclusionary units. Davis, Cal., Ordinance 1567 (June 20, 1990).

cost of capital and home improvements; and costs related to the sale of the unit.<sup>88</sup> Second, potential purchasers must qualify via appropriate income levels. Sometimes it is a seller's responsibility to pre-screen potential purchasers.<sup>89</sup> Other times, a housing agency or other government agency is responsible.<sup>90</sup> Normally, if sellers cannot find qualified buyers within a reasonable time period (generally defined in each program), they may place their units on the open market, sometimes at a controlled price.<sup>91</sup>

Some programs have "rolling" resale restrictions whereby the term of affordability rolls over each time a unit is sold.<sup>92</sup> So if a unit had a ten year affordability term and the owner sold it prior to the expiration of that period, the ten year term would commence anew at the time of the sale.

Another method of maintaining the stock of affordable housing and preventing windfalls in favor of sellers is through a recapture mechanism. Recapture provisions allow the owner of an inclusionary unit to sell that unit on an open market.<sup>93</sup> There is no windfall because the seller must pay to a housing or government agency the difference between the purchase price and a pre-determined amount. The pre-determined amount is typically similar to the amount which the seller can obtain under resale restrictions (i.e., the initial purchase price plus appreciation, cost of improvements, and sales costs).<sup>94</sup> The agency is then responsible for using these funds to either subsidize housing for low- and moderate-income families, or to otherwise ob-

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88. Santa Cruz's price formula, which is typical, provides:

a. The allowable resale price will be set according to a formula established by Council resolution. The final sales price shall be adjusted according to the criteria listed in b, below, provided that in no case shall the maximum allowable sales price be lower than the purchase price of the unit at the time of its last sale plus the seller's closing costs and title insurance.

b. The purchase price of any affordable unit may be increased by:

The value of any substantial structural or permanent fixed improvements which cannot be removed without substantial damage to the premises or substantial or total loss of value of said improvements . . . and such adjustment cannot increase the resale price herewith allowed by more than ten percent.

SANTA CRUZ, CAL., MUN. CODE ORDINANCE 91-45, § 5 (1992) (amending § 24.16.057 of ch. 24.16 of Title 24 of the Municipal Code).

89. For a detailed discussion of the mechanics of resale controls, including administration of same, see MALLACH, *supra* note 14, at 150-58.

90. *Id.*

91. *Id.* at 152.

92. *See, e.g.*, MONTEREY COUNTY, CAL., ORDINANCE ch. 18.40, § 18.40.050 (1994).

93. *See* MALLACH, *supra* note 14, at 155-56.

94. *Id.*

tain a substitute unit for the lost inclusionary unit.<sup>95</sup>

There are two major benefits to the recapture approach. First, it responds to the objection that resale controls overly regulate the free market<sup>96</sup> by allowing an owner to sell a unit to *any* willing buyer, at a price determined by the market. Second, it prevents a seller from obtaining a windfall profit.

Recapture programs are intended to preserve inclusionary units because the "windfall" amount is supposed to be used for affordable housing.<sup>97</sup> However, they do not automatically provide a substitute inclusionary unit for the unit that is lost to the open market. Furthermore, the amount that is recaptured certainly is not adequate to build another inclusionary unit.<sup>98</sup> At best, it will be part of a fund that is used to subsidize housing. Since recapture provisions are not as common as other resale restrictions,<sup>99</sup> there is insufficient evidence to determine whether they provide adequate funding to develop new inclusionary units at a level adequate to make up for lost inclusionary units.

Developers tend to build rental units under inclusionary housing programs with federal or state subsidies or assistance. As a condition to receiving such subsidies or assistance, the government builds in controls to ensure that units are made available to very low-, low-, and moderate-income persons.<sup>100</sup> If rental units are built as part of an inclusionary housing scheme without federal or state subsidies and their accompanying institutionalized regulations for maintaining affordability, program administrators can easily look to federal or

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95. California Assembly Member Bornstein has proposed an amendment to Government Code § 65915 (the density bonus section), which contains a recapture mechanism of sorts. The bill provides that developers are responsible for ensuring the long-term affordability of low-income target units for at least ten years. A.B. 2206, 55th Sess. (Cal. Reg. Sess. 1993) (at proposed § 65915(c)(2)) [hereinafter Proposed CA AB 2206]. If a target unit owner sells that unit to a non-qualified household (i.e., one that is not low-income) within ten years from the date of the original sale, that seller would be responsible for paying an amount calculated pursuant to a formula set forth in the bill to the supervising city, county, or city and county. *Id.*

96. See *infra* text accompanying notes 210.

97. See MALLACH, *supra* note 14, at 156-57.

98. *Id.*

99. However, some inclusionary housing and density bonus programs incorporate recapture provisions. See, e.g., Monterey, Developer's Guide, *supra* note 85, ¶ F; Proposed CA AB 2206, *supra* note 95; Proposed MIHO, *supra* note 14, § 65853.7(a)(7).

100. See, e.g., 24 C.F.R. § 813.102 to .103 (1993) (The HUD Section 8 Rent Subsidy Program which establishes income eligibility guidelines.); 24 C.F.R. § 813.107 (1993) (same program, which establishes maximum monthly housing costs).

state programs for guidance in preserving units as affordable housing.<sup>101</sup> However, it is questionable whether rental units in an inclusionary housing program can sustain their initially low rents on a long term basis without a subsidy, given the increased maintenance costs over the life of a rental project and unforeseen increases in operating costs.<sup>102</sup>

The success of inclusionary housing programs depends on a number of factors, including the specific details of a program and a program's ability to balance the production of affordable housing with incentives adequate to ensure profitability to developers. Efficient and knowledgeable program administration is also important, as is positive receptivity to inclusionary housing by both the local government and population.

#### D. *The Proposed MIHO*

The California legislature recently considered adopting a mandatory statewide inclusionary housing ordinance.<sup>103</sup> Under the Proposed MIHO, California's Department of Housing and Community Development ("HCD") would be responsible for the development of a model mixed-income housing opportunities ordinance, which would then be effective for every local government within the state that did not have its own inclusionary housing program by a given date.<sup>104</sup> Local governments would be free to adopt their own mixed-income housing ordinance, so long as they complied with specified standards.<sup>105</sup> This section will describe the details of the Proposed MIHO.

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101. See, e.g., Long Beach, Cal., Ordinance C-6829, § 1 (Nov. 30, 1990) (amending § 21.60.090, ¶ (E)(1)(b) of the Long Beach Municipal Code), which requires that units be rented to:

persons who either meet the standards for rent subsidy established by HUD pursuant to Section 8 of the Housing Act of 1937, as amended, or to persons who meet the requirements of other rent subsidy or funding program, acceptable to the Authority, that provides rental housing for low income households.

*Id.* It also mandates that a developer use best efforts to accomplish the intent of the chapter. Such efforts include "entering into contracts offered by HUD, the Housing Authority or other such agency administering a rent subsidy program; or, refraining from taking any action to terminate any rent subsidy programs entered into." *Id.* (amending § 21.60.090, ¶ (E)(2)).

102. For example, most apartment projects need substantial repairs after 10-15 years, such as new roofs, carpeting, and appliances. There also may be major operating cost increases resulting from unanticipated events such as compliance with new laws like those dealing with droughts, asbestos removal, disabilities, etc.

103. See Proposed MIHO, *supra* note 14, § 65853.5(c).

104. *Id.* § 65853.7(b)-(c).

105. *Id.* § 65853.7(a)(1)-(10).

The model ordinance, as well as local ordinances, would generally apply only to new construction of ten or more units. The Proposed MIHO would establish a rebuttable presumption that it is financially feasible for local governments to require developers to produce a minimum of ten percent of the ownership units in new residential development areas for sale to households with incomes at or below ninety percent of area median income, and ten percent of the rental units in new residential development areas for rental to households with incomes at or below seventy percent of area median income.<sup>106</sup>

A local ordinance would have to "require that a minimum percentage of housing units in new residential developments be made available to lower to median income households."<sup>107</sup> Prior to specifying program details, a local government would have to conduct a feasibility study to determine both the income levels to which units would be targeted, and the requisite percentage of targeted units.<sup>108</sup> As part of the feasibility study, the locality would be charged with determining the range of income levels the program could serve without public subsidies.<sup>109</sup> In addition, it would:

[C]ompare the affordable prices and rents that households in the area with very low, low, and median incomes, adjusted for family size, can afford, and the prices and rents of the typical owner and rental units currently built by the private market, adjusted by alternative size units. The feasibility analysis shall identify and quantify the value of the proposed reforms and incentives.<sup>110</sup>

Local ordinances would thus require developers to set aside a targeted percentage of inclusionary units based on the feasibility

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106. *Id.* § 65853.7(j). This is a fair provision because it allows local governments to provide evidence that the presumption is not financially feasible. In that event, a developer can negotiate a financially feasible set-aside percentage.

107. *Id.* § 65853.7(a)(2)(A).

108. *Id.*

[T]he local agency shall undertake an economic feasibility analysis, or may rely on information and analysis, provided by the council of governments, the county, or the surrounding city or cities, that ascertains the range of income levels that the private market can reasonably be expected to serve without a public subsidy, but including the financial benefits obtained from the utilization of the reforms and incentives provided for in this section.

*Id.*

109. *Id.* § 65853.7(a)(2)(A).

110. *Id.* § 65853.7(a)(2)(B).

study.<sup>111</sup> The actual income levels of recipients should be the lowest and the targeted percentage of units should be the highest that could be provided without a public subsidy, taking into account regulatory reforms and incentives.<sup>112</sup> A local ordinance could establish that a larger targeted figure than that determined by the feasibility analysis could be built without subsidies, if the ordinance offered developers public subsidies or adequate incentives to offset the costs of complying with the ordinance.<sup>113</sup>

The Proposed MIHO, and local ordinances enacted under it, would have to contain a package of incentives and regulatory reforms designed to offset costs a developer would incur to comply with the ordinance.<sup>114</sup> These would include any reforms and incentives specifically proposed by an affordable housing advisory committee created pursuant to the Proposed MIHO,<sup>115</sup> including, if appropriate:

- (i) density bonuses of at least 25 percent more than what maximum zoning and state law would allow; (ii) reduced street width, parking, sidewalk, floor area ratio, zero-lot line, and set-back standards; (iii)

111.

Consistent with its feasibility analysis, the local agency shall, in an ordinance, require a minimum percentage of the units in . . . new residential development areas to be sold to persons who have low to median incomes, and a minimum percentage of the units in residential rental projects to be rented to persons who have very low to low incomes, pursuant to Section 50079.5 of the Health and Safety Code. "Affordable rent" shall be defined as provided for in Section 50053 of the Health and Safety Code, and "affordable housing cost for homeownership" shall be defined as provided for in Section 50052.5 of the Health and Safety Code.

*Id.* § 65853.7(a)(3).

112. *Id.* § 65853.7(a)(2)(C).

113. *Id.* § 65853.7(a)(2)(D). As is evident, many of the Proposed MIHO requirements are designed to compensate developers for foregone sales of market rate units through various incentives.

114. *Id.* § 65853.7(a)(4).

115. The Proposed MIHO specifies that a local agency which adopts its own ordinance "may create and appoint an affordable housing advisory committee to assist the local agency in preparing a mixed-income housing opportunities ordinance that meets the targeting and financial feasibility goals of this subdivision." *Id.* § 65853.7(a)(5)(A). It continues:

(B) Any advisory committee created pursuant to this paragraph shall reflect the ethnic, gender, and geographical diversity of the county in which the local agency is located, and shall reflect the diversity of policy interests with expertise related to: (i) residential home building; (ii) banking; (iii) labor; (iv) advocacy for low-income persons; (v) affordable housing; (vi) real estate; or (vii) advocacy for fair housing.

(C) The advisory committee shall review the proposed policy, including the proposed regulatory reforms and incentives, at a public hearing, and shall make recommendations to the local agency.

*Id.* § 65853.7(a)(5)(B)-(C).

smaller lots and unit sizes; (iv) design standard modifications for the targeted units; (v) a mix of housing types, including attached units, condominiums, second units, and duplexes; (vi) priority processing; (vii) fee waivers or deferrals; and (viii) development as of right of 4,000 square foot lots in up to 25 percent of the development.<sup>116</sup>

The Proposed MIHO requires developers to meet with local agencies to determine the availability of subsidies. Developers must accept such subsidies, if available.<sup>117</sup>

The Proposed MIHO contains resale restrictions which are designed to balance an inclusionary unit owner's right to profitably sell that unit, with the retention of inclusionary units. It provides:

The local agency shall monitor the ownership units for at least five years after initial occupancy in order to prevent a windfall profit to the owner of a targeted unit. If the unit is sold in five or fewer years, if the initial sale price of the unit was less than or equal to 50 percent of the average price of all units in the development, and if the rate of appreciation on the targeted unit exceeds the average rate of appreciation for single-family ownership units in the area, then the local agency shall capture 50 percent of the equity generated by the gap between the market sales price and the initial sales price of the unit. The local agency shall use all captured equity for the development of additional affordable housing within the jurisdiction.<sup>118</sup>

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116. *Id.* § 65853.7(a)(4)(B).

117. Proposed MIHO, *supra* note 14, § 65853.7(a)(6) provides in part as follows:

If the local agency determines that these housing subsidies are available, the developer shall be required to accept and use the subsidy funds to make the targeted owner or rental units, or additional targeted units, affordable to households with income lower than provided for in paragraph (3), and shall be required to keep the units affordable for the period of time specified under the terms and conditions of the subsidy funds.

*Id.*; *see also id.* § 65853.7(b). These provisions are also designed to ensure that developers can profitably construct inclusionary units.

118. *Id.* § 65853.7(a)(7). The resale restrictions as drafted have a number of problems. For example, they state that a local agency will monitor units for five years. But they do not specify how to monitor ownership and should give some guidance. The restrictions are also very cumbersome, unwieldy, and inefficient. If a unit is sold within five years after purchase, a local agency must go through a complex exercise in fact-gathering and formula application. It must determine the average sales price of all units in the development (during what time period—all initial sales prices, all sales prices within one year of the date that a below market rate owner sells, all sales prices in the history of the development?) and calculate the rate of appreciation of the unit at issue, as well as the average rate of appreciation of all single family homes in the area (what area and during which period?). Once these imperfect calculations are made, depending on whether the initial sales price was less than or equal to fifty percent of the average sales price, and whether the appreciation on the targeted unit



Under the Proposed MIHO, developers would be required to construct inclusionary units throughout a new residential development. Furthermore, *all* units within a new development would have to contain similar features.<sup>119</sup>

The local agency shall require all targeted units to be dispersed throughout the project and have substantially the same exterior appearance so they are not easily identified, and shall require targeted units to have a similar number of bedrooms typical in the nontargeted units. Targeted units may differ in lot or unit size, have fewer and less expensive interior finishes and amenities, and be of different housing types, including but not limited to, attached units, duplexes, condominiums, manufactured housing, second units, half-plexes, and multifamily units. The agency shall require each development phase to include a proportional number of targeted units.<sup>120</sup>

There are some alternatives to building inclusionary units on-site.<sup>121</sup> First, if it is not economically feasible to build inclusionary units on-site, a developer can build the units off-site subject to a number of conditions.<sup>122</sup> Second, if it is not economically feasible to build inclusionary units off-site, a developer can donate land.<sup>123</sup>

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exceeded a certain amount, the local agency would recapture fifty percent of the difference between the initial sales price and the market sales price. A deed restriction would be simpler to administer and would preserve an inclusionary unit, rather than allowing it to be lost by a sale on the open market. This is not intended to be an exhaustive critique of this provision; rather, it is intended to point out apparent flaws.

119. *Id.* § 65853.7(a)(8) (emphasis added).

120. *Id.* The term "half-plex" was apparently "made up" and was intended to identify separate units sharing a common wall. Telephone Interview with Toni Simons, Senior Consultant, Assembly Committee on Housing and Community Development, State Assembly of California, May 24, 1994. It seems a half-plex is the same as a duplex.

121. Proposed MIHO, *supra* note 14, § 65853.7(a)(9)-(10).

122. "The offsite targeted units shall be built concurrently with the nontargeted units, shall be located in the same specific plan area, community plan area, neighborhood, or planning area as the nontargeted units, and shall not be located in an area which has an overconcentration of affordable housing." *Id.* § 65853.7(a)(9).

123.

The local agency may permit the developer to dedicate land to the local agency, local housing authority, or nonprofit housing developer if the land to be dedicated already has local agency approvals necessary to construct housing units, is sufficient in size and equivalent in value and cost to provide the required number of targeted units for the proposed project, has sufficient infrastructure that is onsite or easily accessible, is free of environmental constraints, is located in the same specific plan area, community plan area, neighborhood or planning area as the nontargeted units, and is not located in an area which has an overconcentration of affordable housing.

Third, developers can pay an in-lieu fee.<sup>124</sup>

A final feature of the Proposed MIHO is that interested parties can request that the Affordable Housing Review Committee<sup>125</sup> review a local ordinance to determine whether it meets targeting and feasibility requirements.<sup>126</sup> The Committee would then:

review the local agency's policy, including the proposed regulatory concessions and incentives, at a public hearing and make recommendations to the director. The committee's and director's determinations shall be made on the basis of substantial evidence in the record. In cases where either the committee or the director finds that a local agency's mixed-income housing opportunities policy does not meet state targeting or financial feasibility goals, it may suspend the application of that policy and apply the department's model ordinance, or may apply alternative targeting goals that are financially feasible.<sup>127</sup>

Dozens of organizations, including affordable housing advocates, legal aid groups and other social service entities, support the Proposed MIHO. It is opposed by the California Building Industry Association and the California State Association of Counties.<sup>128</sup> It is part of a three-bill package on growth management<sup>129</sup> that includes Senate Constitutional Amendment 19 which concerns majority vote bonds,<sup>130</sup> and Senate Bill 377 which sets forth a comprehensive state conservation and development policy.<sup>131</sup> Thus, it will not proceed to the governor unless the state legislature arrives at an agreement on all

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*Id.* § 65853.7(a)(10). The odds of complying with all of the foregoing seem marginal at best. Since this second alternative is an unrealistic option, it should be omitted from the MIHO or revised to offer a more practical option.

124.

The local agency may permit payment of an in-lieu fee for developments in situations in which a fraction of an affordable unit would otherwise be required, and for developments of fewer than 50 units in which the ordinance would produce a small number of units. The in-lieu fee shall be adequate to finance the development of the target units, as described in this section, including land purchase within 2 years of initiation of construction of the development.

*Id.* § 65853.7(a)(9).

125. *Id.* § 65853.7(d) (This Committee is established pursuant to the proposed bill.).

126. *Id.* § 65853.7(e).

127. *Id.*

128. ASSEMBLY COMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT, REPORT ON A.B. 1684 6 (Apr. 21, 1993).

129. Proposed MIHO, *supra* note 14.

130. S.C.A. 19, 55th Sess. (Cal. 1993).

131. S.B. 377, 55th Sess. (Cal. 1993).

three bills.

In spring 1993, the bill containing the Proposed MIHO was read before the Assembly Committee on Housing and Community Development and the Assembly Committee on Ways and Means, each of which voted in its favor. It was then referred to the Senate Committee on Housing and Urban Affairs, from which it was withdrawn, and then re-referred to the Senate Committee on Local Government.<sup>132</sup>

### III. POLICY REASONS IN SUPPORT OF INCLUSIONARY HOUSING

Housing should be produced for persons of all income levels. The biggest strength of inclusionary housing is that it produces sorely needed low- and moderate-income housing. As of July 22, 1992, various developers and agencies had produced at least 21,331 inclusionary units under inclusionary housing programs in California.<sup>133</sup> Since most new development is in the suburbs,<sup>134</sup> inclusionary housing programs provide affordable housing where it has traditionally not been available. This is significant because inclusionary housing increases integration and reduces some of the pressure on cities (especially inner cities) by shifting a portion of strained city resources to communities better equipped financially to handle the needs of low- and moderate-income families.<sup>135</sup> There are many other policy reasons in support of inclusionary housing, which will be elaborated in this section. For example, it provides a viable alternative to housing which is 100% publicly financed.<sup>136</sup> It also provides a healthier job and housing balance because it provides more jobs close to employment centers. This, in turn, has a positive economic impact because it reduces costs related to commuting (actual commuter costs and envi-

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132. Because the Proposed MIHO did not pass during the 1993-94 Congressional session, it was automatically killed at the end of the session. With the current political climate, it is unlikely that Assemblyman Hauser will re-introduce the bill anytime soon.

133. CA IH SURVEY, *supra* note 54. Note, however, that not all inclusionary housing programs are equal. For example, as of the time of the survey, a few localities had produced a substantial number of units (Davis, Irvine, and Orange Counties had produced 1000, 4202 and 6389 inclusionary units, respectively), 13 localities had not produced any units, and the remaining localities produced an average of about 271 units each (eliminating the above three localities and any locality which produced no units). *Id.*

134. Among other reasons, downtown land is scarcer than suburban land and many cities have already reached their saturation point.

135. See, e.g., John A. Baade, Note, *Required Low-Income Housing in Residential Developments: Constitutional Challenges to a Community Imposed Quota*, 16 ARIZ. L. REV. 439, 439-40 n.2 (1974).

136. Inclusionary housing admittedly is partially publicly-financed, even if indirectly.

ronmental costs), as well as labor costs (employee absenteeism and moving costs that must be incurred if there is an inadequate employee base). And finally, inclusionary housing, through resale and rental restrictions, has the ability not only to provide affordable housing, but also to preserve affordable housing.

One of the effects of inclusionary housing is increased integration vis-a-vis housing. Federal policy supports socio-economic integration.<sup>137</sup> Courts also support integration as implied by decisions invalidating exclusionary housing.<sup>138</sup> Various courts have in fact extended the promotion of economic integration through housing to include racial integration.<sup>139</sup> Many scholars and advocates for ethnic minorities also support integrated housing.<sup>140</sup> The Proposed MIHO explicit-

137. Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (1974) (codified in scattered sections of 12, 15, 20, 42, and 49 U.S.C. (1988)).

138. See, e.g., *Mount Laurel II*, 456 A.2d 390 (N.J. 1983); *Mount Laurel I*, 336 A.2d 713 (N.J. 1975); *Township of Willistown v. Chesterdale Farms, Inc.*, 300 A.2d 107 (Pa. Commw. Ct. 1973). Scholars also impliedly support integration, as evidenced by their lamentations over the problems which result from exclusionary zoning. "There are serious demoralization costs generated by social immobility and social unrest. Low- and moderate-income people concentrated in economically segregated neighborhoods are denied the full range of opportunities available to the middle and upper classes." Stockman, *supra* note 14, at 546; see also Lawrence G. Sager, *Tight Little Islands: Exclusionary Zoning, Equal Protection, and the Indigent*, 21 STAN. L. REV. 767 (1969).

139. *Metropolitan Hous. Dev. Corp. v. Village of Arlington Heights*, 558 F.2d 1283, 1294 (7th Cir. 1977), *cert. denied*, 434 U.S. 1025 (1978); *United States v. City of Black Jack*, 508 F.2d 1179, 1184, 1186 (8th Cir. 1974), *cert. denied*, 422 U.S. 1042 (1975).

140. See, e.g., ANTHONY DOWNS, *OPENING UP THE SUBURBS: AN URBAN STRATEGY FOR AMERICA* 82 (1973); SEGREGATION, *supra* note 35, at 16; Bruce L. Ackerman, *Integration for Subsidized Housing and the Question of Racial Occupancy Controls*, 26 STAN. L. REV. 245, 266-69 (1974); Michael H. Schill, *Deconcentrating the Inner City Poor*, 67 CHI-KENT L. REV. 795, 808 (1991). Racially mixed residential areas provide more economical use of community facilities. Further,

residential contact would afford people the opportunity to judge others on individual merit rather than racial stereotypes, resulting in fuller utilization of manpower and leadership resources. In addition, reduction of prejudicial attitudes toward the minority group would provide them with benefits ranging from increased proximity to work to better quality education, housing and other services.

SEGREGATION, *supra* note 35, at 16. Note, however, that some commentators question whether integration is socially desirable. One commentator argues that it may interfere with localism. Stockman, *supra* note 14, at 559. Others argue that racial integration could harm racial groups by diluting both voting and general support powers, as well as engendering hostility between those who leave and those who stay behind. SEGREGATION, *supra* note 35, at 16. Also, homogeneity purportedly correlates with "less violent crime, less property crime, better academic performance by students, less rancorous conflict in public decision-making, more fiscal integrity in the community's budget process, and closer congruity between public opinion and governmental policy." Stockman, *supra* note 14, at 561 (quoting G. Alan Tarr & Russell S. Harrison, *Legitimacy and Capacity in State Supreme Court Policymaking: The New*

ly states that one of the goals of the program is to "[c]reate increased ethnic and economic integration throughout each community."<sup>141</sup> Most inclusionary housing programs require that inclusionary units be dispersed throughout a new development, rather than clustered together. This promotes mixed income neighborhoods at the same time that it allays arguments and fears of NIMBY vocalists and affordable housing opponents.<sup>142</sup> If affordable housing is more evenly distributed among market priced units, it can give lower economic classes access to better educational opportunities, discourage economic segregation, and avoid concentration of affordable housing in already blighted sections of cities and counties.<sup>143</sup>

Concentration of [affordable] units is considered undesirable because experience with large-scale, low-income housing projects indicates that they tend to deteriorate both physically and socially, and frequently become unsafe for residents as well as the surrounding neighborhood. It is believed that scattering affordable units throughout conventional projects may avoid these problems by encouraging better tenant maintenance, increased community acceptance, and higher quality construction.<sup>144</sup>

Dispersing inclusionary units development-wide, combined with designing such units to match the market rate units, is more palatable to residents with NIMBY attitudes. This diminishes the possibility that inclusionary units will negatively impact property values. Community opposition to the production of affordable housing through

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*Jersey Court and Exclusionary Zoning*, 15 RUTGERS L.J. 513, 562-63 (1984)). Thus by inference, integration would not correlate with those benefits. However, it seems that the homogeneity "advantages" described by Stockman would only be valid if the homogeneous group described is a middle- or upper-class group. Others support economic integration generally, but believe that it should be accomplished through housing at the community rather than at the neighborhood level. See generally NINA J. GRUEN & CLAUDE GRUEN, *LOW AND MODERATE INCOME HOUSING IN THE SUBURBS, AN ANALYSIS FOR THE DAYTON, OHIO REGION* 119-45 (1972).

141. Proposed MIHO, *supra* note 14, § 65853.5(c)(2).

142. The MIHO program was designed in part to "[c]reate less neighborhood opposition to affordable housing as a result of not having to wedge affordable housing into existing built up areas." *Id.* § 65853.5(c)(5).

143. Linda J. Bozung, *A Positive Response to Growth Control Plans: The Orange County Inclusionary Housing Program*, 9 PEPP. L. REV. 819, 831-32 (1982) [hereinafter Bozung, *A Positive Response*]; Thomas Kleven, *Inclusionary Ordinances-Policy and Legal Issues in Requiring Private Developers to Build Low Cost Housing*, 21 UCLA L. REV., 1432, 1458 (1974).

144. Linda J. Bozung, *Inclusionary Housing: Experience Under a Model Program*, ZONING & PLAN. L. REP. (Jan. 1983), at 91 [hereinafter Bozung, *Inclusionary Housing*].

inclusionary housing programs should therefore decrease. By spreading inclusionary units throughout a community, inclusionary housing could accomplish economic, as well as racial, integration.

Suburban integration is merely a subset of the foregoing, applying specifically to suburban areas that have traditionally been homogeneous with respect to income and race to a significantly greater degree than cities.<sup>145</sup> The benefits of suburban integration have been succinctly described as follows:

1. Better access to expanding suburban job opportunities for workers in low- and moderate-income households—especially the unemployed
2. Greater opportunities for such households to upgrade themselves by moving into middle-income neighborhoods, thereby escaping from crisis ghetto conditions
3. Higher quality public schooling for children from low-income households who could attend schools dominated by children from middle-income households
4. Greater opportunity for the nation to reach its officially adopted goals for producing improved housing for low- and moderate-income households
5. Fairer geographic distribution of the fiscal and social costs of dealing with metropolitan-area poverty
6. Less possibility of major conflicts in the future caused by confrontations between two spatially separate and unequal societies in metropolitan areas
7. Greater possibilities of improving adverse conditions in crisis ghetto areas without displacing urban decay to adjacent neighborhoods.<sup>146</sup>

Since most new housing is developed in suburban areas rather than in central cities, the integration impact of inclusionary housing will be strongest in the suburbs.<sup>147</sup> If one accepts the proposition that integration is a desirable goal, then inclusionary housing should certainly be supported as a means not only of providing affordable housing, but also of furthering social and economic integration in

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145. Kleven, *supra* note 143, at 1435-36 (Kleven notes that subsidized housing had traditionally not been built in the suburbs probably due to exclusionary land use regulations, high land prices, and developers' general desires to maximize profits. In addition, suburban areas generally have less used-housing than urban areas, so filtering works less efficiently.). For a general discussion of filtering, see *infra* text accompanying notes 222-29.

146. DOWNS, *supra* note 140, at 26.

147. *But see* Stockman, *supra* note 14, at 566-68.

traditionally segregated suburban areas.

Inclusionary housing can potentially spread the cost of providing affordable housing over a number of parties, rather than placing the burden primarily on the government. Housing for very low-, low-, and moderate-income persons has admittedly not always been 100% publicly financed.<sup>148</sup> But in light of governmental budget reductions generally, and in the area of housing particularly, the possibility of major public financing for affordable housing will further diminish. While there has been federal funding for affordable housing programs for decades, in the early 1980s, starting with the Reagan administration and continuing through the Bush administration, the federal role in the production of affordable housing has decreased to the point of being insignificant.<sup>149</sup> Thus, it is more important than ever to develop alternate solutions to the affordable housing problem. Inclusionary housing is one solution which shifts the burden of providing affordable housing from federal and state government to local governments and developers. In addition, it has the potential of providing a wider base of support for affordable housing by forcing private developers, public agencies, and non-profit entities, among others, to work together.

California's Proposed MIHO is representative of this spirit as it was intended to:

provide a prudent, economically sound way, when combined with regulatory reforms and incentives, to increase the long-term supply of affordable housing without imposing unrealistic burdens on local government services, without saddling the private sector with unreasonable requirements that impair its ability to provide affordable housing, and without diverting valuable public services from their most effective use.<sup>150</sup>

To illustrate, even though inclusionary housing programs require

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148. MALLACH, *supra* note 14, at 6-11.

149. In discussing housing problems generally, one housing expert noted:

The above perceived [housing] failures and frustrations pale, however, by comparison with that experienced during the period following 1980, as the Reagan administration effectively eliminated over a period of less than three years any meaningful federal role in the production of new housing for low- and moderate-income households. It has long been recognized that with isolated and typically sporadic exceptions, neither state nor local government was capable of providing funding for housing programs in any manner capable of replacing the lost federal funds.

*Id.* at 5-6. See generally HAYS, *supra* note 19, at 239-66.

150. Proposed MIHO, *supra* note 14, § 65853.5(b)(1).

developers to provide affordable housing, they typically provide incentives to the developers and frequently work with them to determine if any government financing, subsidies, or other forms of assistance are available for a particular project.<sup>151</sup> Thus, inclusionary housing provides an additional source of affordable housing from a partnership of many parties, rather than placing the burden all on the government.

Recently, there has been a significant trend toward relocating low-skilled jobs to the suburbs, leaving cities with more professional and managerial jobs and fewer low-skilled jobs.<sup>152</sup> When employers with many low-skilled jobs move their operations to suburban areas where affordable housing is not available for many of their employees, a housing-job imbalance arises.<sup>153</sup> This imbalance is exacerbated by prevalent suburban exclusionary zoning practices. These practices encourage commercial development, which produces favorable tax rateables.<sup>154</sup> At the same time, they discourage affordable housing development, because affordable housing produces less revenue than commercial development or higher priced homes, and it houses residents who have traditionally used greater than average municipal services.<sup>155</sup> Inclusionary housing advocates point out that one of the advantages of inclusionary housing is that it promotes a greater job and housing balance by increasing access to employment centers for low- and moderate-income persons.<sup>156</sup> In addition to moderating the housing-job imbalance by providing affordable housing close to employment centers, inclusionary housing programs also produce related,

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151. See, e.g., *supra* text accompanying note 117.

152. Peter Dreier, *America's Urban Crisis: Symptoms, Causes, Solutions*, 71 N.C. L. REV. 1351, 1373-76 (1993).

153. Stockman, *supra* note 14, at 543.

154. David G. Andersen, *Urban Blight Meets Municipal Manifest Destiny: Zoning at the Ballot Box, the Regional Welfare, and Transferable Development Rights*, 85 NW. U. L. REV. 519, 557 (1991) (noting that commerce generally adds more revenue to the tax base than it consumes by using municipal services).

155. Stockman, *supra* note 14, at 540.

156. Mary E. Brooks, *Housing Trust Funds: Lessons from Inclusionary Zoning*, in INCLUSIONARY ZONING MOVES DOWNTOWN 7, 10 (Dwight Merriam et al. eds., 1985); Paul Davidoff & Linda Davidoff, *Opening the Suburbs: Toward Inclusionary Land Use Controls*, 22 SYRACUSE L. REV. 509, 513 (1971). Brooks points out that one of the original selling points of inclusionary zoning was that it provided increased access to employment opportunities. In discussing the housing-job imbalance, she noted that "[w]hile employment centers were then rapidly expanding in suburban areas, low and moderate-income housing, affordable to many employees, was virtually non-existent. . . . Inclusionary zoning ordinances worked to provide a greater balance between available employment and available housing." *Id.*



desirable side effects of saving time and energy, which in turn decreases employee absenteeism and environmental damage.<sup>157</sup>

The Proposed MIHO would simultaneously alleviate the housing-job imbalance and "improve air quality, reduce traffic congestion, increase the labor pool, and allow shorter commutes between work and home by providing affordable housing for employees that is closer to their jobs."<sup>158</sup> When the economy is depressed like it is presently, especially in California, inclusionary housing could provide positive side effects. For example, it could preserve jobs in the state by allowing employers to attract employees with the promise of affordable housing.<sup>159</sup> Among the findings in the Proposed MIHO was that "[t]he shortage of decent, affordable housing makes it difficult to create, expand, and retain businesses, thereby threatening the state's economic future."<sup>160</sup> Thus, the Proposed MIHO and inclusionary housing programs generally, can help correct the housing-jobs imbalance, thereby retaining both employers and employees, and injecting a needed boost into the California economy.

Many compelling reasons support inclusionary housing, the most significant being the production of affordable housing. The reasons justifying inclusionary housing are strengthened by the crisis evidenced by the affordable housing shortage,<sup>161</sup> the skyrocketing numbers of homeless persons, and the lack of existing or planned solutions to this problem.<sup>162</sup>

#### IV. INCLUSIONARY HOUSING CRITICISMS: CRACKS IN THE FOUNDATIONS

There are many policy reasons against, and criticisms of, inclusionary housing programs. This section will examine these concerns and criticisms, ultimately concluding that some of them are illusory, and that the remaining valid problems of inclusionary housing do not outweigh its benefits.

Some of the primary arguments against inclusionary housing are

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157. Bozung, *Inclusionary Housing*, *supra* note 144, at 90.

158. Proposed MIHO, *supra* note 14, § 65853.5(b)(4).

159. Bozung, *Inclusionary Housing*, *supra* note 144, at 90 ("Business enterprises demand a nearby supply of employees and are often forced to leave a community when that employee supply dwindles as a result of escalating housing costs."); Davidoff & Davidoff, *supra* note 156, at 513.

160. Proposed MIHO, *supra* note 14, § 65853.5(a)(4).

161. MALLACH, *supra* note 14, at 9.

162. Dreier, *supra* note 152, at 1365.

that it inhibits free market forces, redistributes wealth, and may even operate as a hidden tax.<sup>163</sup> Opponents argue that inclusionary housing programs pass the burden of solving a society-wide problem from government to a small private sector, and that sector is neither directly, nor wholly, responsible for the problem.<sup>164</sup> Resale controls may be invalid restraints on alienation. Critics argue that inclusionary housing can slow down, or halt, housing production altogether.<sup>165</sup> Furthermore, while it may help some low- or moderate-income households, the number is relatively small compared with the number of people who need affordable housing. This is exacerbated by the problem of qualifying for inclusionary units. There is a limited number of people who earn enough to save for the requisite down payment and qualify for a loan, but do not earn so much that they bump themselves from the program. There are related administrative problems such as determining who qualifies for housing under a program, how to prioritize qualified applicants, and how to restrict resales. Critics also argue that it is inefficient to build brand new housing for low- and moderate-income families when filtering<sup>166</sup> and other mechanisms are available to provide affordable housing in a more cost effective manner. Finally, many programs apply to all new developments.<sup>167</sup> This is impractical in smaller developments.

Opponents of inclusionary housing argue that by its nature, it functions to redistribute wealth.<sup>168</sup> Inclusionary housing forces a small segment of the population to provide, and pay for, low cost housing for select parties who would otherwise not be able to afford such housing.<sup>169</sup> The qualified parties who are selected to purchase

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163. MALLACH, *supra* note 14, at 86.

164. *Id.* at 11. In discussing opposition to inclusionary housing, Mallach noted that "[s]uch opposition was particularly apparent where observers perceived such programs as being the means whereby government could shift the responsibility for problems, often of its own making, off the public sector and onto the private sector to the development and home-building industry." *Id.*

165. *Id.* at 88.

166. Filtering is a passive mechanism which provides used-housing which "filters" through various income groups, with each successive group in a lower income bracket than the preceding group. For a detailed description of filtering, see *infra* text accompanying notes 222-29.

167. Robert Collin & Michael Lytton, *Linkage: An Evaluation and Exploration*, 21 URB. LAW. 413, 413 (1989); John M. Payne, *Housing Impact Fees*, 20 REAL EST. L.J. 75, 75 (1991).

168. MALLACH, *supra* note 14, at 86.

169. See, e.g., Ronald H. Silverman, *Subsidizing Tolerance for Open Communities*, 1977 WIS. L. REV. 375, 453.

or rent inclusionary units benefit from inclusionary housing.<sup>170</sup> The more troubling issue is, at whose expense? There is neither a simple nor a single answer. The response depends in large part on the mechanics of a particular program, as well as the community in which the program is situated. There may be one primary "payor," but it is more likely that there is a combination of payors, possibly including developers, city or county governments, federal or state governments, landowners, and market rate purchasers or renters in developments subject to inclusionary housing. It is impossible to determine a precise formula for allocation of costs in implementing an inclusionary program. However, in order to fairly analyze this criticism of inclusionary housing, it is appropriate to discuss the parties likely to pay under given circumstances.

Wealth is redistributed *from* developers, who pay for inclusionary housing if they receive a lower price for inclusionary units than they would absent inclusionary housing requirements, unless they are otherwise adequately compensated. Developers can be compensated through a package of incentives. Alternatively, developers can "pass costs backwards" to landowners by paying less for land subject to inclusionary housing regulations than they would otherwise pay. Finally, developers can "pass costs forwards" to market rate buyers or renters.<sup>171</sup>

Local, state, and federal entities may offer a variety of incentives to developers. For example, they can offer low interest financing or bond programs that are intended to offset the costs imposed by an inclusionary housing program.<sup>172</sup> One of the most common incentives is a density bonus. In order for a density bonus to be effective, it must allow a developer to build enough units so that the cost of building inclusionary units can be recouped, at least in part, through the production of more market rate units than would otherwise be permitted.<sup>173</sup> Other common incentives fall under the rubric of zon-

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170. While it is easy to identify who benefits, it is somewhat troubling to determine which of the many qualified applicants will benefit. For a discussion of the mechanics of this issue, see *supra* text accompanying notes 78-81.

171. Robert C. Ellickson, *The Irony of "Inclusionary" Zoning*, 54 S. CAL. L. REV. 1167 (1981).

172. For a general discussion of incentives, see *supra* notes 69-70 and accompanying text.

173. See Kathleen Morgan-Martinez, *Local Control in Low-Income Development: The Promise of California's Article 34*, 33 SANTA CLARA L. REV. 765 (1993); Serena M. Williams, *The Need for Affordable Housing: The Constitutional Viability of Inclusionary Zoning*, 26 J. MARSHALL L. REV. 75, 86 (1992).

ing code reforms, which may include tandem parking<sup>174</sup> or reduced parking stall depth and guest parking requirements, or reduced street widths and set-back requirements. Inclusionary housing programs frequently provide that inclusionary units may be smaller than market rate units and offer fewer amenities.<sup>175</sup> A locality may reduce or waive development fees altogether.<sup>176</sup> Local governments can also expedite project processing which saves money, and as importantly, time. Less tangible but every bit as important, a locality can engage in community education to lessen fears and resistance to affordable housing.<sup>177</sup> There may also be other incentives or any combination of the above-listed incentives.

If the value of incentives is not greater than the cost of complying with inclusionary housing requirements, rather than take a loss, a developer can attempt to pass costs backward or forward.<sup>178</sup> Costs are passed backward if a developer pays less for land because it is subject to inclusionary housing regulations.

In essence, the effect of an inclusionary housing program on land value in a given zone, all other standards being held constant, is identical to that of a downzoning of the same land. As the prospective income stream from the property is reduced, the value of the land is proportionately diminished.<sup>179</sup>

Thus, owners of undeveloped land may pay, at least in part, for

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174. "A tandem parking space is a parking space that abuts a second parking space in such a manner that vehicular-access to the second space can only be made through the abutting (tandem) space." Theodore C. Taub, *Transportation and Parking Regulations as Growth Management*, in LAND USE INSTITUTE: PLANNING, REGULATION, LITIGATION, EMINENT DOMAIN AND COMPENSATION 429, 499 (1989).

175. EUGENE J. MEEHAN, PUBLIC HOUSING POLICY: CONVENTION VERSUS REALITY 34 (1975).

176. For a discussion on development fees, see Jane E. Schukoske, *Housing Linkage: Regulating Development Impact on Housing Costs*, 76 IOWA L. REV. 1011, 1018 (1991).

177. The NIMBY Report made several suggestions directly related to education. For example, Recommendation 8-2 provides:

The Commission recommends that government leaders and concerned organizations and individuals build coalitions to support regulatory reform and affordable housing. Professional and civic organizations should examine the consequences of the NIMBY syndrome; private and community foundations should sponsor studies of and debate on regulatory reform; and government officials should join with private citizens to address the implications of NIMBYism. Government, business, nonprofit, and educational leaders should take the lead in forming local coalitions to translate public awareness into support for regulatory reform and affordable housing.

NIMBY REPORT, *supra* note 21, at 8-8, 8-9.

178. MALLACH, *supra* note 14, at 88.

179. *Id.* at 90.

inclusionary housing. While this may seem unfair, the bundle of rights obtained through property ownership<sup>180</sup> has generally not been interpreted to include a right to a given rate of return on property.<sup>181</sup> A landowner's risk of paying for inclusionary housing under the above circumstances is no different than the risk of depreciation generally inherent in real property ownership. For example, any property can be down-zoned, a neighborhood may deteriorate, a commercial route may be established through an area, etc. Regardless of the foregoing, whether a developer can pass costs backward is not really in the developer's control. It is more a function of the market and the extent to which neighboring property is subject to inclusionary housing. If demand for land exceeds supply, undeveloped land will maintain its value or appreciate, even if it is subject to inclusionary housing. If all land in a given locality is subject to inclusionary housing, then no particular parcel will be disproportionately impacted. Therefore, the market, not the developer, controls land values.

A developer may also try to pass costs forward. Market rate purchasers in a development subject to inclusionary housing may subsidize inclusionary units if the developer increases the price of their units to cover any losses incurred due to the production of inclusionary units.<sup>182</sup> One of the stronger criticisms of inclusionary housing programs is that it is inequitable for market rate buyers, who

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180.

Real property includes the interests, benefits, and rights inherent in the ownership of physical real estate. Real property includes the "bundle of rights" that is inherent in the ownership of real estate.

In the bundle of rights theory, ownership of real property is compared to a bundle of sticks. Each stick represents a distinct and separate right, which may be the right to use real estate, to sell it, to lease it, to enter it, to give it away, or to choose to exercise more than one or none of these rights.

*Berkeley Arms Apartment Corp. v. Hackensack City*, 6 N.J. Tax 260, 282 (1983) (citing AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, *THE APPRAISAL OF REAL ESTATE* 8 (8th ed. 1983)).

181. However, if government action prompts a takings question, the Supreme Court noted that one factor which a court will consider as part of its analysis, is a property owner's "distinct investment-backed expectations," which are determined in part by a "reasonable rate of return" on property. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124, 136-38 (1978). To the extent that a regulation deprives a property owner of the opportunity to earn a reasonable rate of return, the regulation may be an unconstitutional taking. *Nash v. City of Santa Monica*, 688 P.2d 894, 900 (Cal. 1984); *Seawall Assocs. v. City of New York*, 542 N.E.2d 1059, 1065-66 (N.Y. 1989). But, in our case, the regulation would only indirectly affect a landowner, and it is too far-fetched to entertain a takings analysis of such a challenge.

182. Ellickson, *supra* note 171, at 1190.

may earn only marginally more than those who qualify for inclusionary units, to pay a disproportionate share of the cost of inclusionary programs.<sup>183</sup> However, the possibility of market rate units subsidizing inclusionary units is again dependent more on the nature and status of the community, and the housing market in general, than any factor in a developer's control. For example, if a market is fairly elastic and a home buyer has a choice of buying a three bedroom home for \$100,000 in City A which is subject to inclusionary housing, or the same size home for \$90,000 in City B which is not subject to inclusionary housing, then all else being equal, the home buyer almost certainly will buy in City B. It is only if all is *not* equal that the buyer will pay a premium to live in City A.<sup>184</sup> In other words, a developer can pass inclusionary housing costs forward *only* if a market is not perfectly elastic or a buyer is willing to pay a premium for a home in an area that is subject to inclusionary housing.<sup>185</sup> Thus, the economics of a given housing market and the premium attached to certain communities will determine whether, and to what extent, a developer can pass inclusionary housing costs on to market rate buyers.

Clearly, developers can charge more for any unit, regardless of whether there is an inclusionary housing program, if the market justifies that price. In this sense, excess costs attributable to inclusionary housing programs can be analogized to exactions since they are passed on to market rate purchasers in the same way in which exactions for schools, sewers, etc., are passed along.<sup>186</sup> It may not be

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183.

Since home buyers of units in higher-density developments, which include inclusionary housing, are assumed to be middle class rather than the rich who buy in estate areas, which are usually not subject to such provisions, the system is said to be particularly inequitable. The rich are getting off free and the middle classes are carrying the entire burden.

Henry A. Hill, *Government Manipulation of Land Values to Build Affordable Housing: The Issue of Compensating Benefits*, 13 REAL EST. L.J. 3, 13 (1984). Note, however, that estate areas are generally no longer immune from affordable housing requirements because most inclusionary housing programs contain regulations that apply to *all* new development within a locality, not just particular projects. If it is economically infeasible to include inclusionary units on site, most programs allow off-site production or in-lieu fees, but all new homes are nonetheless affected.

184. See MALLACH, *supra* note 14, at 88-89.

185. *Id.* at 89-90. For example, Palo Alto is a very desirable place to live, partly because of its proximity to Stanford University. Thus, many people will pay a premium to buy a house in Palo Alto, even if they could obtain a similar home for a lower price in nearby Mountain View or Redwood City.

186. For a discussion of the exaction analogy in a legal context, see *infra* text accom-

fair to all home buyers, but the transfer of these costs to home buyers has been upheld.<sup>187</sup>

Assuming that a builder is able to earn acceptable profits, even with inclusionary housing, there is no need to analyze further whether inclusionary housing is fair vis-a-vis developers. Even if their profits are not maximized, developers will still realize acceptable profits. Therefore, developers will still develop.

If incentives are not adequate to compensate developers for compliance costs, and if developers cannot pass costs backward or forward, then there are two major consequences. The theoretical consequence is that developers will pay a disproportionate amount of the cost of solving the affordable housing problem. This is one of the most forceful critiques of inclusionary housing.<sup>188</sup> The Supreme Court has not directly addressed the general unfairness of this aspect of inclusionary housing. In a takings context, however, it has stated that "[o]ne of the principal purposes of the Takings Clause is '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.'"<sup>189</sup> Aside from the patent unfairness of the foregoing, if developers, by themselves, have to bear the cost of an inclusionary program, the practical consequence is that there will be little or no new development.<sup>190</sup>

As noted, however, it is unlikely that developers will incur significant costs to comply with inclusionary housing requirements. Even if some costs are incurred, the imposition of an inclusionary program can be characterized as a cost of development. In that respect, exactions arguably impose much more significant costs on developers than inclusionary programs. "Indeed, there is a certain irony in many builders' protests over the enactment of inclusionary housing programs, inasmuch as substantially greater costs, arguably serving the public interest less, have long been recognized as a part of the cost of doing business by the industry."<sup>191</sup> Thus, developers will probably be compensated for costs of complying with inclusionary housing

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panying notes 362-67.

187. See *infra* text accompanying notes 362-65.

188. MALLACH, *supra* note 14, at 88.

189. *Nollan v. California Coastal Comm'n*, 483 U.S. 825, 835 n.4 (1987) (citing *Armstrong v. United States*, 364 U.S. 40, 49 (1960)). For a detailed discussion of the takings issue, see *infra* part V.A.

190. MALLACH, *supra* note 14, at 88.

191. *Id.* at 95.

through incentives. Even if not 100% compensated, any remaining costs would simply be absorbed as a cost of doing business.

Developers are not the only party which may pay for inclusionary housing. Local governments also pay part of the cost if they provide developers with a package of incentives. Various incentives impose different types of costs.

Some incentives, such as expedited processing, do not impose any direct costs (although they may impose a cost on competing developers who do not get those benefits). Other "indirect cost" incentives include assisting in obtaining federal or state grants, subsidies, or bond-financing. This type of assistance really involves nothing more than work which government employees would handle in the normal course of their employment. While financing through tax-free bonds imposes a cost on a very broad base, it does not impose a direct cost on a local government. Incentives such as fee waivers, reduced or waived infrastructure, or off-site improvement requirements, do not impose a direct cost on local governments, but may impose an indirect cost.<sup>192</sup> Otherwise, the benefit of inclusionary housing could be gained through a tax on the community.<sup>193</sup> A local government may alternatively require such benefits from other developers, or they may simply be forfeited.<sup>194</sup>

Inclusionary housing critics have suggested that it would be more equitable to pay for affordable housing through a general tax, rather than to have a small segment of the population, such as developers, pay for it.

With respect to the inclusionary ordinances, even if the need for lower priced housing can be connected to new residential development, it also arises from earlier residential and non-residential development, and the benefits from filling the need flow more to the community at large than to the particular developments. If costs must be incurred to bring about the lower priced housing, it seems

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192. If developers do not provide improvements which they would otherwise be required to provide, the local government must provide them.

193. *See, e.g.*, CAL. GOV'T CODE §§ 53311-53365.5 (West 1983 & Supp. 1994) (covering California's Mello-Roos tax which funds public education, as well as other community facilities).

194. For example, a community may pay if a school that might have been financed through development fees is still built, but the funding for the school is provided through a tax increase or special assessment, or through exactions paid by other developers. Or, if a developer would normally be required to provide a school and the municipality waives that requirement, then the community pays by both sacrificing the school and suffering overcrowding of existing schools.



fairest that they be borne by the entire community through general taxation.<sup>195</sup>

In response, it is likely that a general tax, even if fairer, would be so unpopular that it would not be approved and few politicians would risk their careers on such a proposal. Thus, even though a general tax may be more equitable, it is not a realistic or viable alternative.

An inclusionary housing critic has argued that inclusionary programs are hidden "taxes on the production of new housing. The programs will usually increase general housing prices, a result which further limits the housing opportunities of moderate-income families. In short, despite the assertions of inclusionary zoning proponents, most inclusionary ordinances are just another form of exclusionary practice."<sup>196</sup> However, inclusionary programs often do not increase housing prices of market rate units.<sup>197</sup> If they do, the increase is similar to that caused by exactions, and generally is not more than the market will bear. So long as developers receive adequate incentives, including density bonuses, it is more likely that general housing prices will not increase. Thus, if programs are effectively designed, they should not cause a general increase in housing prices.

Some people object to inclusionary housing because choosing beneficiaries is too arbitrary and the class of beneficiaries is too limited.<sup>198</sup> While income is always a threshold qualifying standard, some programs establish a priority system for qualified applicants based on criteria such as current residence or employment within the locality.<sup>199</sup> Thus, with limited supply and great demand, there may be an attempt to give priority to households deemed more "worthy." However, even among this narrower class, demand still exceeds supply. A small percentage of this select group will be awarded homes which they obtain at below market prices. But, compared to the tremendous number of people who suffer as a result of the affordable housing crisis, it is true that a relatively small number of people benefit from these programs.<sup>200</sup> There also is criticism that the limited group of

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195. Kleven, *supra* note 143, at 1499.

196. Ellickson, *supra* note 171, at 1170.

197. See *supra* notes 182-85 and accompanying text; see also Holmdel Builders Ass'n v. Township of Holmdel, 583 A.2d 277, 294 (N.J. 1990) (arguing against the concept that inclusionary housing programs serve as a tax on market rate units).

198. However, the same could be said about any entitlement program or about lotteries for that matter.

199. See *supra* text accompanying note 80.

200. "[A]t one project site located in Orange County, 12,000 people applied to buy 392

chosen beneficiaries is not necessarily the group with the greatest need for affordable housing. It has been wryly noted that it is not "evident that the decision [of who will receive inclusionary units] is going to significantly help the urban poor; upwardly mobile urban Yuppies perhaps, but not those on welfare or without a job."<sup>201</sup>

With respect to the criticism that a small class benefits from inclusionary housing, it is clear that a small group of beneficiaries is better than no beneficiaries. Each household assisted by inclusionary housing is a testament to the strength of inclusionary housing; it provides housing otherwise not affordable to very low-, low-, and moderate-income families.

The validity of the criticism that most inclusionary housing beneficiaries are not those with the greatest need is questionable. There is a need for housing for very low-, low-, and moderate-income households. If a program helps fill any of those needs, it is successful. Furthermore, some programs intentionally target the class of beneficiaries attacked above (i.e., moderate-income households). For example, a report analyzing the feasibility and need for an inclusionary housing program specified that "[t]eachers, police officers, fire fighters, nurses, secretaries and bank tellers are among those in need of affordable housing in San Diego."<sup>202</sup> If inclusionary housing successfully fills the need for moderate-income housing, then it may be appropriate to alter some programs to target housing affordable to people in other income categories. But, it is inappropriate to criticize a program because it only provides affordable housing for some people.

Although inclusionary housing programs have allowed moderate-income families to purchase homes, they admittedly have not been as successful at providing purchase opportunities for people in the lowest income categories.<sup>203</sup> The main reasons are that most low-income persons cannot qualify for financing of inclusionary units and acquire the requisite down payment. Even if they can overcome these obstacles, they cannot necessarily make their monthly payments or afford upkeep on the units.<sup>204</sup> Inclusionary housing programs, however,

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inclusionary units." Gary Smalker, *Inclusionary Housing: A Wrong Approach*, L.A. DAILY J., Nov. 16, 1981, § 1, at 4; see also MALLACH, *supra* note 14, at 19-20.

201. Richard F. Babcock, *The Zoning Game—Revisited*, ZONING & PLAN. L. REP., Sept. 1985, at 145, 148.

202. SAN DIEGO INCLUSIONARY HOUSING TASK FORCE, FINAL REPORT: CREATING A MORE LIVABLE COMMUNITY 6 (1992).

203. Brooks, *supra* note 156, at 14.

204. "The poor are too poor to own homes, even affordable ones." Donna Horowitz, *Bid*

have succeeded in providing rental housing for very low- and low-income households.<sup>205</sup> While inclusionary housing may not provide all income groups an opportunity to purchase a home, more importantly, it does provide affordable housing for those income groups with the greatest need.

On the other side of the income scale, people who earn just above the moderate-income limitations imposed by inclusionary housing programs, make too much to qualify for inclusionary units.<sup>206</sup> In discussing market rate purchasers, one commentator noted that "[i]n most cases, these home buyers will consist of many people who, although not members of the protected class of lower-income home buyers, may be only marginally wealthier than the protected class."<sup>207</sup>

The criticism here is two-pronged. First, the class of people who earn enough to qualify for a home loan, but do not earn so much that they exceed the income ceiling limitations imposed by inclusionary housing programs, is very small.<sup>208</sup> This criticism seems unwarranted insofar as the number of applicants for inclusionary units is generally significantly higher than the number of available units. Program administrators often must resort to a lottery to determine the lucky few beneficiaries.<sup>209</sup>

The second criticism is that the line between those who qualify for inclusionary housing and those who do not is arbitrary, thus rewarding one group, but excluding another which may earn only marginally more than the qualifying group. This inequity can be compounded if a locality funds incentives through general taxation, because then the group with an income just above the line is disproportionately burdened (vis-a-vis higher income residents who

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to Make Low-income Homes Attached Units, MARIN INDEP. J., Feb. 2, 1993, at B1. This article described a developer's request to convert proposed detached units to attached units based on the concern that low-income families could not afford the upkeep on homes that would have sold for about \$80,000 under an inclusionary housing program, but would have otherwise sold at the market rate of about \$500,000. *Id.*

205. Monterey County has produced at least 90 low-income units, with construction of an additional 700 units pending. Telephone Interview with Frank Brunings, Monterey County Housing Coordinator (Jan. 25, 1994). Berkeley has produced 36 units under inclusionary housing programs, with 32 additional units approved or under construction. Telephone Interview with Nathan Landau, Berkeley Zoning Office (Jan. 25, 1994).

206. Babcock, *supra* note 201, at 148.

207. Hill, *supra* note 183, at 24.

208. MALLACH, *supra* note 14, at 20; Babcock, *supra* note 201, at 148.

209. See *supra* notes 79, 81 and accompanying text.

pay proportionately less of their income for these taxes). It would also be compounded if a developer passes costs forward to market rate home buyers. These are valid criticisms. However, inclusionary housing by itself cannot solve the affordable housing crisis, it can only offer a partial solution. But, in light of the affordable housing crisis, it would be imprudent to decline support of a program which provides some affordable housing because it does not provide 100% of such housing, and that an income class just above those benefitted may be disproportionately impacted.

Resale restrictions provide fuel for the fire of inclusionary housing critics. While critics recognize that inclusionary housing programs are designed to increase the stock of affordable housing through the initial construction of inclusionary units and retention of them through resale and other restrictions, they still object to resale restrictions for a number of reasons. Their main objections are that the restrictions interfere too much with the free market, take away one of the sticks comprising the bundle of property rights, and are too hard to draft and supervise.

The biggest concern with respect to resale restrictions is that they represent too great a governmental intrusion into private property and free market operations.<sup>210</sup> Resale restrictions, like rent control restrictions, are criticized because they go too far in controlling land values. They do artificially restrain appreciation of real property, thereby burdening real property owners subject to such restrictions. However, without resale restrictions, the success of inclusionary housing programs would be limited to a single generation of inclusionary unit owners.

A related objection to resale controls stems from pro-property right sentiments and the longstanding policy disfavoring unreasonable restraints on alienation.<sup>211</sup> Many real property owners have strong convictions that they can do what they please with their property (subject, of course, to reasonable regulations<sup>212</sup>), including earning

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210. MALLACH, *supra* note 14, at 147. However, many of the people who make this argument would probably accept governmental involvement vis-a-vis zoning and other land use regulations if such regulations maintain or enhance property values.

211. CAL. CIV. CODE § 711 (West 1994) ("Conditions restraining alienation, when repugnant to the interest created, are void."); RESTATEMENT (SECOND) OF PROPERTY 142 (1983) (Part II, Direct Restraints on Alienation in Donative Transfers). For a discussion of the legality of resale restrictions, see *infra* part V.C.

212. It has long been recognized that in order to promote the general welfare, property can be regulated. See, e.g., *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 428, 434-36 (1934).

the maximum return or appreciation on their property that the market allows. Not surprisingly, some of the same property owners who favor inclusionary programs when the programs allow them to buy homes at affordable prices, later object to resale restrictions when they want to sell their units. But for most inclusionary unit owners, "the present opportunity to buy a home that they could otherwise not afford far outweighs the future potential loss of windfall benefits."<sup>213</sup>

Like most regulations, resale restrictions are not good for everybody. The benefits of resale restrictions, however, outweigh their burdens. Without resale restrictions, the affordable housing stock created by inclusionary housing programs would disappear and a very small group of homeowners would obtain a substantial windfall.

While it is difficult to formulate and supervise effective resale controls,<sup>214</sup> many governmental entities have done so successfully. At a state level, legislation may be enacted which mandates that units purchased pursuant to inclusionary housing programs remain available as affordable housing if the state has provided subsidies or other assistance for the housing. For example, California has a statute that requires a locality to ensure the continued affordability of units within a development if the locality has provided various types of assistance or incentives.<sup>215</sup> Individual cities and counties currently regulate resales through various provisions, some of which are admittedly more effective and equitable than others.<sup>216</sup> Thus, while it is not easy to formulate restrictions, governing entities can and do preserve affordability of inclusionary units by restricting sales, leases, assignments and other transfers of units for a given period of time.<sup>217</sup>

Resale restrictions should be carefully drafted to provide a seller

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213. MALLACH, *supra* note 14, at 147.

214. Rental controls are also important. Otherwise, owners of inclusionary units could rent their homes for market rent and pocket the profit represented by the difference between their monthly mortgage payments and market rental. Most programs have some occupancy requirements. There may be exceptions under particular circumstances, but the unit would generally have to be rented to a qualified party.

215. "Where there is a direct financial contribution to a housing development . . . through participation in costs of infrastructure, write down of land costs, or subsidizing the cost of construction, the city, county, or city and county shall assure continued availability for low- and moderate-income units for 30 years." CAL. GOV'T CODE § 65916 (West 1994); see also Proposed CA AB 2206, *supra* note 95.

216. For a discussion of resale controls generally, see *supra* text accompanying notes 82-92.

217. Affordability is generally preserved through deed restrictions, covenants, or similar means. For a discussion of typical resale restrictions, see *supra* text accompanying notes 84-85.

with a fair return while ensuring that the unit remains affordable. Without resale restrictions, the supply of inclusionary units created through inclusionary programs would diminish and first generation sellers would obtain a windfall profit at the expense of other parties.

Another problem with resale restrictions is that during the initial period after adoption of an inclusionary housing program, the restrictions will be accompanied by extra costs and time delays. These arise in connection with familiarizing parties such as lenders and title companies with resale restrictions, and obtaining their approval of the restrictions. This is a short term problem that must be dealt with every time a regulation is enacted which affects title or property financing.

Inclusionary housing has been criticized because it has the potential to slow or shut down housing production.<sup>218</sup> Some economists criticize inclusionary housing, especially units for purchase, primarily because someone must pay if developers are required to sell inclusionary units at less than market value. Generally, if a developer sells a unit at market value, the developer will recover "normal" profits. However, if the developer is required to sell below market, the developer will make "below normal" profits, possibly break even, and maybe even lose money. The outcome depends on a number of factors, including the elasticity of the housing market.<sup>219</sup> This criticism is valid if developers are not offered enough incentives to make development worthwhile. In other words, if there is little chance of making an acceptable profit, few for-profit developers will build housing and the prediction that housing production will be stymied, or even halted, would likely occur. Thus, it is critical to the success of an inclusionary housing program that it offer adequate incentives to

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218. Bernard Siegan, *Commentary on Redistribution of Income Through Regulation in Housing*, 32 EMORY L.J. 721, 721-22 (1983) (Inclusionary zoning, if not accompanied by compensating bonuses, creates a strong disincentive to development and construction of new housing.); CLAREMONT MCKENNA COLLEGE, STUDY OF LAW STRUCTURES, HOUSING POLICY IN ORANGE COUNTY, CALIFORNIA 1960-1980 72-73 (Dec. 1982).

[C]urrent housing policies have the net effect of reducing the overall stock of housing below what it would be without these policies. With respect to inclusionary housing, specifically, the number of inclusionary units is higher than it otherwise would be, but the number of non-inclusionary units falls so much that the total stock of housing is reduced. Over the long run, the stock of housing will grow about half as fast with inclusionary policy as without.

*Id.*

219. See *supra* text accompanying notes 182-85; see also Muth, *supra* note 26, at 708-09.

entice a developer to build.<sup>220</sup>

Opponents of inclusionary housing argue that it is not cost-effective and that there are more efficient ways to provide affordable housing.<sup>221</sup> The thrust of the argument is that the money used to produce new housing could go a lot further through other programs or mechanisms such as filtering, rehabilitation, and rent subsidies.

Filtering is not an active housing policy. Rather, it is a process that may naturally occur when middle- and upper-income households vacate existing homes and move to new, more expensive homes. This in turn results in an increased supply of housing for low- and moderate-income families.<sup>222</sup>

A substantial number of low- and moderate-income families do obtain housing through the filtering process, without the intervention of any housing programs.<sup>223</sup> Filtering is thus an economical way to provide affordable housing. Inclusionary housing critics argue that it should therefore be the housing policy of choice.<sup>224</sup> While filtering

220. For a detailed discussion of who pays for inclusionary housing and the role that incentives play in determining who pays, see *supra* notes 168-96 and accompanying text.

221.

New construction is needed to maintain an ample supply of low cost housing; however, too great a reliance on new construction raises . . . key issues. One is cost; clearly new construction of privately owned units is very expensive on a per unit basis, especially since investors seem to demand deep tax subsidies, as well as direct rent subsidies, as a condition for risking their money on the disadvantaged.

HAYS, *supra* note 19, at 258. "Therefore, the use of existing standard units to house the poor is a useful way to spread resources further and to achieve a better mix of families served." *Id.*

222. Filtering has been succinctly described as follows:

As time passes, the housing units in this neighborhood become older and less stylish compared to newer units. Housing fashions change swiftly in the United States—probably faster than anywhere else in the world. . . .

At the same time, the real incomes of many households initially living in this neighborhood increase. Many move to even newer housing units that are larger, more stylish, and in "fancier" neighborhoods. . . .

As more time passes, the once new housing becomes less and less desirable compared to the newest and best in society, even if it is well maintained. Because it is occupied by a succession of *relatively* lower and lower income groups, it eventually houses groups with *absolutely* much lower incomes than those who first lived there. . . . Finally, the housing becomes occupied by the lowest income groups in society and falls into extreme disrepair.

At that point, this housing has "trickled down" through society's income distribution from near the top to the bottom.

DOWNES, *supra* note 140, at 4-5.

223. Ellickson, *supra* note 171, at 1185.

224. See *id.*; see also MALLACH, *supra* note 14, at 39. While Mallach does not necessarily subscribe to this belief, he summarizes the argument as follows:

may be an efficient mechanism for providing affordable housing, it has a few problems. First, it is ineffective where housing demand is greater than supply because resale home values appreciate, rather than depreciate, in those markets.<sup>225</sup> Accordingly, costs for resale homes may be equal to, or greater than, the cost of new homes.<sup>226</sup> Second, the quality of housing at the bottom of the filtering process is frequently sub-standard.<sup>227</sup> Thus, even if it is affordable, it is probably not up to code and may be ripe for demolition. Finally, filtering perpetuates economic segregation as it lumps people with like-income together throughout the entire trickling down process.<sup>228</sup> Economic integration is a stated goal of housing policy<sup>229</sup> that simply cannot be met through the filtering process.

Rehabilitating existing housing is another way to solve the affordable housing crisis. Rehabilitation is certainly more efficient than construction of new housing, and it sometimes makes sense to upgrade existing housing rather than to build housing from scratch. But rehabilitation suffers from shortcomings similar to those that plague filtering. For example, it improves sub-standard housing, but often just barely. It perpetuates segregation.<sup>230</sup> Finally, because most sub-standard housing is located in inner cities, rehabilitation is limited to those areas and does little to improve the affordable housing shortage in suburban areas. Thus, rehabilitation is one of the solutions that should be pursued to deal with the shortage of affordable housing. It alone, however, cannot solve all the problems connected with the affordable housing crisis.

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[Less affluent] households buy or rent older units as they filter down from the more affluent, and it is therefore more appropriate as well as more economically efficient to construct new units largely or entirely for the more affluent share of the market. Furthermore, by interfering with that process, new construction for less affluent households is not only inefficient, but arguably diminishes housing opportunities for lower-income households by reducing the amount of filtering taking place.

*Id.*

225. MALLACH, *supra* note 14, at 40.

226. *Id.* at 40-41.

227. *Id.* at 40.

228. *See id.* at 42 (pointing out that filtering "reinforces existing discrepancies between urban and suburban areas and between areas of economic growth and stagnation").

229. Housing and Community Development Act of 1974, Pub. L. No. 93-383, 88 Stat. 633 (1974) (codified in scattered sections of 12, 15, 20, 42, and 49 U.S.C. (1988 & Supp. V 1993)).

230. Generally projects in inner city or run down areas, which tend to be segregated, are targeted for rehabilitation.



Rent subsidies are also part of the solution to the affordable housing problem. However, they cannot operate by themselves and depending on the type of subsidy involved, the subsidy may not actually be used for housing. For example, some subsidies to renters are based on a median rental rate in the relevant geographical area, rather than on an actual rental rate.<sup>231</sup> With such subsidies, a family may choose to live in cheap, sub-standard housing and use the difference between the subsidy and the actual amount paid for housing, for other living expenses such as food. In that case, the rent subsidy helps the recipient pay for living expenses, but it does not help place the recipient in a decent home. As another example, subsidies may only be available for use in public housing which is generally in inner cities. While such subsidies do provide housing, they still perpetuate economic segregation and limit real housing choices. Subsidies are also used in connection with inclusionary housing,<sup>232</sup> and without them, housing might not be available to occupants of inclusionary units. In this case, they are an essential component of a solution, but they are not the entire solution. While subsidies are integral to solving the affordable housing crisis, they often must be combined with other programs to be effective. Thus, they should and must remain part of the strategy to solve the housing problem. But, they are not by themselves an effective substitute for inclusionary housing.

Some inclusionary housing programs require participation from all new housing developers, regardless of the size of the contemplated development.<sup>233</sup> Critics argue that it is inefficient and impractical to impose such a program on small developments. For example, if a landowner lives in a city with inclusionary housing that requires twenty percent of all new development to be set aside for low- and moderate-income families, and the landowner wants to build a single house on a lot, it would be impractical to set aside twenty percent of the house as affordable housing. Most localities handle this by either excusing small projects, or allowing developers to purchase and sell credits, to provide off-site affordable housing, or to pay a fee in-lieu of providing housing.<sup>234</sup> Prior to drafting an inclusionary housing

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231. For a description of this type of rental subsidy program, see HAYS, *supra* note 19, at 247-48.

232. See *supra* text accompanying note 69.

233. See, e.g., Carlsbad, Cal., Ordinance NS-232 (Apr. 20, 1993). However, this does not require construction of an inclusionary unit if a developer is only building a single unit; in that case a developer may pay an in-lieu fee. *Id.* § 21.85.050.

234. See *supra* text accompanying notes 71-74.

program, a locality should perform a feasibility analysis which determines the minimum number of units which can profitably be developed under the requirements of the program.<sup>235</sup> The program should not apply to any projects smaller than the number established in the study, or it should allow small project developers one of the above options in-lieu of providing on-site housing. Thus, there are many ways to avoid this problem altogether or to mitigate the problem.

An additional difficulty related to this last problem arises from the option of paying a fee in-lieu of producing inclusionary units. In many high priced communities, developers select this option and do not produce any on-site units.<sup>236</sup> While this still produces significant funds for affordable housing, it does not necessarily result in the production of affordable housing,<sup>237</sup> and even when it does, units are generally produced inefficiently because most localities and housing agencies are not in the housing development business.<sup>238</sup> Thus, localities that include in-lieu options should be careful to include a mechanism for efficiently converting collected funds into inclusionary units. For example, they could require that funds be used to rehabilitate existing housing; provide funding for non-profit developers to build affordable housing; or provide funding or additional incentives for other developers to build inclusionary units in addition to those which they are required to build.

235. See, e.g., Proposed MIHO, *supra* note 14, § 65853.7(a)(2).

236. For example, as of the time the California Inclusionary Housing Survey was produced, Coronado and Del Mar had not produced any units under their inclusionary housing programs, even though their programs had been in place for 7-12 years. As of early 1994, they had collectively obtained fees in the amount of \$1,637,500. Telephone Interview with Ann McCall, Assistant Planner, Community Development Department of the City of Coronado, and Steve Power, Associate Planner, Planning/Community Development Department of the City of Del Mar. While it has not built new units with its funds, Coronado has used most of its in-lieu fees to rehabilitate SRO's (single resident occupancy) and for rental assistance subsidies. Del Mar uses its funds primarily to rehabilitate older units. Although these forms of assistance certainly help ameliorate the affordable housing crisis, they technically do not follow the letter of inclusionary housing programs because they do not produce new units which are dispersed throughout new developments. *Id.*

237. *Id.*

238. MALLACH, *supra* note 14, at 176. One building association executive commented that:

[i]n Ventura and other places where this approach [inclusionary zoning] was taken, . . . most developers simply paid a fee in lieu of constructing such units. Local agencies then found themselves in the building business and were unsuccessful in cutting costs substantially. "Research showed that inclusionary zoning produced very few inclusionary units."

Roger M. Showley, *Building Group's New Chief to Push Affordable Housing*, SAN DIEGO UNION-TRIB., Feb. 16, 1992, at F29.

There are a number of criticisms of inclusionary housing, many of them valid. However, several of the criticisms can be resolved through the mechanics of a program and public education regarding the need for affordable housing and the benefits of dispersed affordable housing.<sup>239</sup> If they cannot be so resolved, even recognizing their validity, the problems still do not outweigh the benefits of inclusionary housing.

#### V. LEGAL CHALLENGES: TAKINGS, DUE PROCESS, EQUAL PROTECTION, AND RESTRAINTS ON ALIENATION

This part analyzes legal challenges on the grounds that inclusionary housing programs constitute takings, violate substantive due process and equal protection, and impose invalid restraints on alienation. The analysis is necessary in order to determine the legal validity of inclusionary housing generally, and the Proposed MIHO specifically. Since many of the relevant legal tests require a fact specific inquiry, it is difficult to conclude authoritatively that all inclusionary housing programs would survive all legal challenges. However, any program, including the Proposed MIHO, would be upheld so long as it is reasonably related to a legitimate governmental purpose; is not arbitrary or capricious; does not cause a property owner to suffer a total economic loss; does not unfairly discriminate against a particular party; and provides incentives sufficient to allow the average developer to earn a reasonable profit.

##### A. Takings

This section focuses on takings jurisprudence and analyzes whether key provisions common to inclusionary housing programs could withstand takings challenges. The Fifth Amendment of the United States Constitution prohibits the taking of private property without just compensation.<sup>240</sup> The Fifth Amendment applies to the states through the Fourteenth Amendment.<sup>241</sup> Most state constitutions also prohibit local and state governments from taking private property without just compensation.<sup>242</sup> Thus, both federal and state constitu-

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239. See NIMBY REPORT, *supra* note 21, at 8-1.

240. U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

241. U.S. CONST. amend. XIV.

242. See, e.g., the California Constitution, which provides that "[p]rivate property may be taken or damaged for public use only when just compensation . . . has first been paid." CAL.

tions limit governmental power to take private property for public use.

Land use regulations are sometimes deemed regulatory takings. Regulatory takings tests used over the last century have been fluid, changing with the composition of courts and reflecting current social, economic, and jurisprudential values and norms. The main issue that arises under the Proposed MIHO and most inclusionary housing programs is whether requiring developers to provide housing for very low-, low-, and moderate-income households, which requirement may not only deprive developers of a profit, but actually cause them to lose money, is a regulatory taking. I conclude that this type of provision would probably be upheld so long as the particular challenged program provided adequate incentives to allow a developer to earn reasonable profits. Since there is no singular takings test, in order to analyze the issues appropriately, keeping in mind the current legal temperament, it is important to trace the development of takings jurisprudence.

### 1. General History of Takings Jurisprudence

Takings are generally divided into physical and regulatory classifications. Physical takings are much easier to analyze. If property is physically appropriated, there is clearly a taking and the government will usually be required to compensate the private property owner.<sup>243</sup> Thus, physical invasions of private property, whether permanent or temporary,<sup>244</sup> and without regard to the physical quantity of property

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CONST. art. I, § 19.

243. With respect to physical invasions of property, "[i]n general (at least with regard to permanent invasions), no matter how minute the intrusion, and no matter how weighty the public purpose behind it, we have required compensation." *Lucas v. South Carolina Coastal Council*, 112 S. Ct 2886, 2893 (1992); *see also* *Griggs v. Allegheny County*, 369 U.S. 84 (1962) (holding that government had engaged in a taking by appropriating an air easement over plaintiff's home so that flights could land and take off safely); *United States v. Causby*, 328 U.S. 256 (1946) (same).

244. In *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, the Court addressed the issue of compensation for temporary takings occurring *prior* to the ultimate invalidation of a challenged regulation. 482 U.S. 304, 313 (1987). Even though the challenged regulation in this case was designed to protect public health and safety (it prevented construction of a summer camp for handicapped persons in a flood zone), the Court ordered compensation because the regulation denied the property owners of *all* economically viable use while the regulation was in effect. *Id.* at 321. While this case dealt with a theoretically regulatory taking, a taking which denies a property owner *all* economically viable use of land may be considered a permanent taking because the owner has no right to use the property. *Id.* at 318; *see also* *Kaiser Aetna v. United States*, 444 U.S. 164 (1979) (ordering government to compensate in light of finding of regulatory taking). *But see* *PruneYard Shop-*

invaded,<sup>245</sup> are generally compensable takings. This is true regardless of whether the physical invasion renders the value of property worthless, even if the taking achieves an important public benefit.<sup>246</sup>

The law governing regulatory takings is much more obfuscated. The courts have not established a bright-line test for determining whether a regulation constitutes a compensable taking. The Supreme Court has stated that it "quite simply, has been unable to develop any 'set formula' for determining when 'justice and fairness' require that economic injuries caused by public action be compensated by the government, rather than remain disproportionately concentrated on a few persons."<sup>247</sup> However, in most regulatory takings cases, courts attempt to strike an equitable balance between the legitimate use of state police power for the health, safety, welfare and morals of its residents (the "public interest"), and a party's private property interest (the "private interest").<sup>248</sup>

Legal challenges to takings are either "facial" or "as-applied."<sup>249</sup> A facial challenge would allege that the mere enactment of a regulation constitutes a taking; an as-applied challenge would allege specific injury or losses resulting from the enforcement of a regulation.<sup>250</sup> A facial challenge is evaluated by using the "no economically viable use" test,<sup>251</sup> while an as-applied challenge is more likely to apply the "*Penn Central*" test.<sup>252</sup> The Proposed MIHO itself would likely

ping Center v. Robins, 447 U.S. 74 (1980).

245. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 436, 438 n.16 (1982). The challenged statute, which allowed cable companies to install equipment in apartment buildings, was held to be a compensable taking because it permanently deprived building owners of the use of a portion of their property. *Id.* "We affirm the traditional rule that a permanent physical occupation of property is a taking. In such a case, the property owner entertains a historically rooted expectation of compensation, and the character of the invasion is qualitatively more intrusive than perhaps any other category of property regulation." *Id.* at 441.

246. See generally *Loretto*, 458 U.S. 419; *Mugler v. Kansas*, 123 U.S. 623 (1887).

247. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978) (citations omitted).

248. See, e.g., *Mugler*, 123 U.S. at 668-69.

249. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 494, n.23 (1987) (quoting *Keystone Bituminous Coal Ass'n v. Duncan*, 771 F.2d 707, 710, n.3 (1985)).

250. *Id.* at 494-95.

251. See *id.* at 495. "The test to be applied in considering this facial challenge is fairly straightforward. A statute regulating the uses that can be made of property effects a taking if it 'denies an owner economically viable use of his land.'" *Id.* (citations omitted).

252. *Hodel v. Virginia Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 295 (1981). For a description of the *Penn Central* test, see *infra* note 267 and accompanying text; see also *DeBenedictis*, 480 U.S. at 485-502 (utilizing the *Penn Central* factors). See generally Andrea L. Peterson, *The Takings Clause: In Search of Underlying Principles Part I-A Cri-*

confront a facial challenge, whereas a specific developer who has commenced a project would likely raise an as-applied challenge to thwart any attempts to enforce the law against him.

The tests employed over time to determine how much weight should be accorded each of the public and private interests, and what circumstances should cause the scale to tip one way or the other, are significant enough to warrant some discussion.

Two early Supreme Court cases, *Mugler v. Kansas*<sup>253</sup> and *Hadacheck v. Sebastian*,<sup>254</sup> best illustrate the Court's initial approach to deciding takings cases. In each case, the Court differentiated between non-compensable regulations enacted pursuant to validly exercised police power, and compensable regulatory takings.<sup>255</sup> In the late 1800s, if regulations' purposes or effects were to protect the public from harm, then the Court did not balance the public and private interests, upholding the regulations without compensation to a private property owner.<sup>256</sup> The rationale was that the state is responsible for protecting public health, safety, and morals and that laws designed to promote these interests were seen as legitimate mechanisms to prevent landowners from creating nuisances, rather than encroaching upon private property rights.<sup>257</sup> Regulations intended to exact public benefits were likewise upheld in both of these cases, but the government was required to compensate a private property owner.<sup>258</sup>

In a 1922 landmark decision, *Pennsylvania Coal Co. v. Mahon*,<sup>259</sup> the Supreme Court held that a state act prohibiting subsidence coal mining constituted a compensable taking.<sup>260</sup> The Court determined that the Kohler Act<sup>261</sup> made it commercially impracticable for plaintiff to mine certain coal.<sup>262</sup> Even though the purpose

*tique of Current Takings Clause Doctrine*, 77 CAL. L. REV. 1299, 1316-34 (1989).

253. 123 U.S. 623 (1887). The *Mugler* Court held that a ban on the production and sale of alcohol was noncompensable. See *id.* at 671.

254. 239 U.S. 394 (1915). The *Hadacheck* Court confirmed that a zoning ordinance which resulted in the prohibition of a brickyard operation in a residential area was noncompensable. See *id.* at 412-14.

255. See *Hadacheck*, 239 U.S. at 409-12; *Mugler*, 123 U.S. at 657-59, 667-69.

256. *Hadacheck*, 239 U.S. at 410-11; *Mugler*, 123 U.S. at 669.

257. *Hadacheck*, 239 U.S. at 410-11; *Mugler*, 123 U.S. at 669.

258. *Hadacheck*, 239 U.S. at 409; *Mugler*, 123 U.S. at 669.

259. 260 U.S. 393 (1922).

260. *Id.* at 414.

261. Act of Pennsylvania, P.L. 1198 (May 27, 1921) (the "Kohler Act").

262. The Kohler Act effectively prohibited the plaintiff coal company from mining under a single private residence where such mining could collapse the residence. *Pennsylvania Coal*, 260 U.S. at 412-13. Prior to enactment of the Kohler Act, the residence owner purchased the

of the Kohler Act was to protect homeowners from the harm caused by mining that would undermine their houses' foundations and lead to collapse, the Court held that a complete diminution in the economic value of plaintiff's private property interest required compensation.<sup>263</sup> By so deciding, the Court balanced the Kohler Act's prevention of harm (the public interest), against the costs borne by a property owner (the private interest). On one side of the scale, the Court looked at the regulation's financial impact on the private interest and determined that regulatory action could not deprive a property owner of *all* economic property use.<sup>264</sup> This concept of property's economic value to the private interest has been incorporated into takings analysis as one factor used in assessing whether a regulation requires compensation.

*Pennsylvania Coal* established a noted shift in the focus of takings analysis from total reliance on the character of a regulation, to a balance between the public and private interests. This pragmatic approach was inevitable as there is no clear line between a regulation which prevents public harm and one which grants a public benefit. Almost any regulation can be characterized as having both attributes.

In 1978, the Court revisited the economic loss issue in *Penn Central Transportation Co. v. New York City*.<sup>265</sup> Here, New York City designated Grand Central Station as an historic landmark, prohibiting plaintiff from constructing a multi-story building in the airspace above its private property.<sup>266</sup> Plaintiff challenged the designation as a taking. The Court examined "the economic impact of the regulation," the extent to which the regulation interfered with plaintiff's investment-backed expectations, and "the character" of the regulation.<sup>267</sup>

With respect to the first factor, the Court found that in relation to the plaintiff's entire bundle of property rights, the diminution in property value resulting from the regulation was by itself, inadequate

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surface of the property, granting plaintiff the right to remove all the underlying coal, and waiving all claims for damages arising from coal mining. *Id.* at 412.

263. *Id.* at 414-15.

264. *Id.* at 414.

265. 438 U.S. 104 (1978).

266. See N.Y. GEN. MUN. LAW § 96-a (McKinney 1977); *Penn Central*, 438 U.S. at 109-15 & n.5.

267. *Penn Central*, 438 U.S. at 124, 130-31. "The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations." *Id.* at 124. See generally Peterson, *supra* note 251, at 1317-27.

to find a taking.<sup>268</sup> As to the next factor, even though the challenged regulation interfered with the plaintiff's investment-backed expectations, the Court held that, so long as the plaintiff could earn a reasonable return, there was no compensable taking.<sup>269</sup> It did find, however, that the more a regulation interferes with investment-backed expectations, the more the scales will weigh in favor of the private interest.<sup>270</sup> The *Penn Central* Court did not award compensation, emphasizing the plaintiff's ability to retain a reasonable investment return.<sup>271</sup>

Regarding the final factor, the Court held that "[t]he restrictions imposed are substantially related to the promotion of the general welfare."<sup>272</sup> Accordingly, the legitimacy of an act is evaluated based on "the government's justification for its action."<sup>273</sup> Unfortunately, the Court specifically declined to provide a formula for weighing and balancing the factors.<sup>274</sup>

In *Agins v. City of Tiburon*,<sup>275</sup> the Court articulated a two-prong test to determine whether a regulation required compensation.<sup>276</sup> First, the Court inquired whether government action advanced a legitimate state interest.<sup>277</sup> Second, it considered whether government action denied landowners "economically viable use" of their property.<sup>278</sup>

Under the *Agins* test, a court will find a compensable taking if a government regulation either fails to "advance [a] legitimate state

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268. *Penn Central*, 438 U.S. at 130-31; see also *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 497-99 (1987) (further defining the bundle-stick analysis).

269. *Penn Central*, 438 U.S. at 136-38.

270. See *Penn Central*, 438 U.S. at 124.

271. *Id.* at 136.

272. *Id.* at 138 (finding that the regulation's purpose of preserving buildings or areas with special historical, architectural, or cultural significance was a valid exercise of authority). One could, however, make a very strong argument that the designation came closer to exacting a public benefit than preventing a public harm. In fact, the dissent argued that the purpose of the legislation was to preserve art and not to prohibit a public nuisance, thereby rendering it a compensable taking. See *id.* at 144-46 (Rehnquist, J., joined by Berger, C.J. and Stevens, J., dissenting).

273. Peterson, *supra* note 251, at 1318-19.

274. *Penn Central*, 438 U.S. at 124. For a discussion of the *Penn Central* test generally, see Peterson, *supra* note 252, at 1317-27.

275. 447 U.S. 255 (1980). The challenged regulation was a zoning restriction which limited plaintiffs' ability to develop their property, allowing them to develop a maximum of five single family residences on a five acre parcel. *Id.* at 257.

276. *Id.* at 260; see also Peterson, *supra* note 252, at 1327-30.

277. *Agins*, 447 U.S. at 260.

278. *Id.*



interest *or* denies an owner economically viable use of his land."<sup>279</sup> Under the first prong, the Court held that the city's police power could be used to enact the challenged regulation, reasoning that "[t]he zoning ordinances benefit the appellants as well as the public by serving the city's interest in assuring careful and orderly development of residential property with provision for open-space areas."<sup>280</sup> Under the second prong, the Court held that appellants were not denied all economically viable use of their land because they still had a right to build up to five houses on their property.<sup>281</sup> "At this juncture, the appellants are free to pursue their reasonable investment expectations by submitting a development plan to local officials."<sup>282</sup>

In 1987, the Court decided two land use cases that further clouded the already murky water of takings jurisprudence.<sup>283</sup> In *Keystone Bituminous Coal Ass'n v. DeBenedictis*,<sup>284</sup> the Court looked first at the character of the challenged regulation.<sup>285</sup> The Court held that the challenged statute furthered legitimate state interests in protecting, among other things, the state's health and environment.<sup>286</sup> The Court denied compensation even though the regulation destroyed the property's value, reasoning that "[c]ourts have consistently held that a State need not provide compensation when it diminishes or destroys the value of property by stopping illegal activity or abating a public nuisance."<sup>287</sup>

The Court also looked at the "investment-backed expectations" factor, finding that the scale here similarly weighed in favor of the

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279. *Id.* (emphasis added) (citations omitted).

280. *Id.* at 262.

281. *Id.* at 262-63.

282. *Id.* at 262.

283. *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987); *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470 (1987).

284. 480 U.S. 470 (1987).

285. *Id.* at 485-93. Like *Pennsylvania Coal*, coal operators in this case challenged a statute which prohibited coal mining that caused a potential for collapse of above ground structures. *Id.* at 474 (citing Pennsylvania Subsidence Act, PA. STAT. ANN., tit. 52, § 1406.4 (1966 & Supp. 1994)).

286. *Id.* at 488. The Court distinguished the Kohler Act which did *not* substantially advance a legitimate state interest, because the Kohler Act advanced the rights of individuals (by protecting private parties who specifically waived and released their right to support). *Id.* at 485-88. The challenged act in this case, on the other hand, "protect[ed] the public interest in health, the environment, and the fiscal integrity of the area," *id.* at 488, thus passing muster under the character of the regulation test. *Id.* at 488-92. See Peterson, *supra* note 252, at 1329-30.

287. *DeBenedictis*, 480 U.S. at 492 n.22 (citations omitted).

public interest.<sup>288</sup> It relied on the fact that the plaintiff coal operators did *not* allege that the statute rendered their operations unprofitable.<sup>289</sup> The Court distinguished *Pennsylvania Coal*, implying that, even if the plaintiffs had alleged that they were denied all economically viable use of their land, the statute would still be upheld.<sup>290</sup>

Analyzing the economic impact factor, the Court looked at the plaintiffs' total property interest.<sup>291</sup> It held that an entire parcel must be rendered useless, not merely a strand in the bundle of property rights.<sup>292</sup> Significantly, Justice Rehnquist wrote a dissenting opinion in which Justices Powell (who is no longer on the Court), O'Connor, and Scalia joined, arguing that property segmentation *can* be utilized to determine whether a taking has occurred.<sup>293</sup> With a differently composed Supreme Court—such as today's Court<sup>294</sup>—this case may well have turned out differently.

The Court has occasionally required compensation when a challenged regulation interferes with "essential property rights," regardless of the value maintained by a landowner.<sup>295</sup> In such instances, the balance between public and private interests favors the private. For example, in *Nollan*, the Court held that a regulation requiring uncompensated conveyance of an easement across plaintiff's beach front property violated the Fifth Amendment, even though plaintiff retained considerable value.<sup>296</sup> It reasoned that the state's attempt to acquire the easement was invalid because no sufficient nexus could be established between the condition imposed and plaintiff's request to build.<sup>297</sup> Thus, the *Nollan* Court expanded the first prong of *Agins* by requiring a nexus between a land use regulation enacted under the

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288. *Id.* at 493.

289. *Id.*

290. "In this case, by contrast [to *Pennsylvania Coal*], petitioners have not shown any deprivation significant enough to satisfy the heavy burden placed upon one alleging a regulatory taking." *Id.*

291. *Id.* at 497-98 (Plaintiffs argued that they lost all value as to one strand, that is, the coal which they could not mine.).

292. *Id.* at 498-99.

293. *Id.* at 515-20.

294. Since 1987, Justices Brennan, Marshall, Blackmun, and White (who joined the majority opinion), as well as Powell (who joined the dissent), have departed from the Court. Justices Kennedy, Souter, Thomas, Ginsburg, and Breyer have joined the Court.

295. See, e.g., *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987).

296. *Id.* at 841-42. The easement was required as a condition to approval of a building permit for a home on the property. *Id.* at 828.

297. *Id.* at 836-37.

police power and the social harm it is designed to alleviate.<sup>298</sup>

*Lucas v. South Carolina Coastal Council*,<sup>299</sup> did little to clarify this area of the law. In *Lucas*, the Court looked at whether a landowner must be compensated if a state bars all construction on that land to protect the public interest.<sup>300</sup> It held that a regulation is a compensable taking if it denies a landowner *all* economically viable land use, subject to some exceptions.<sup>301</sup>

The *Lucas* decision in effect blended the *Agins* two-prong test into one analysis. The threshold inquiry is whether a regulation denies all economically viable land use.<sup>302</sup> If it does, the owner must be compensated *unless* the regulation is based upon antecedent common law property and nuisance principles.<sup>303</sup> If some value remains, then the inquiry is converted to a balancing between the public and private interests.<sup>304</sup> A difficult issue here is what if there is *some* economically viable use, i.e., at what point in the continuum between maximum economic value and no economic value is a property owner compensated?<sup>305</sup>

298. *Id.* at 837.

299. 112 S. Ct. 2886 (1992).

300. *Id.* at 2889. The regulation was designed to protect coastal property. *Id.*

301. *Id.* at 2901-02. The exceptions arise if a regulation is based on existing, identifiable "background principles of nuisance and property law that prohibit the uses [plaintiff] now intends in the circumstances in which the property is presently found." *Id.* On remand, the state court determined that no exceptions applied. Therefore, the state owed *Lucas* compensation based on a total and temporary deprivation of land use. *Lucas v. South Carolina Coastal Council*, 424 S.E.2d 484, 486 (S.C. 1992) (holding additionally that *Lucas* could still seek a special permit to construct a dwelling, and it was thus premature to order damages for permanent deprivation).

302. "Property is generally deprived of all economically beneficial use where construction is banned entirely, such as when the property is required to remain as open space." Ehrlich v. Culver City, 19 Cal. Rptr. 2d 468, 475 (Ct. App. 1993) (in reliance on *Lucas*).

303. *Lucas*, 112 S. Ct. at 2901-02.

304.

The "total taking" inquiry we require today will ordinarily entail (as the application of state nuisance law ordinarily entails) analysis of, among other things, the degree of harm to public lands and resources, or adjacent private property, posed by the claimant's proposed activities, . . . the social value of the claimant's activities and their suitability to the locality in question, . . . and the relative ease with which the alleged harm can be avoided through measures taken by the claimant and the government (or adjacent private landowners) alike.

*Id.* at 2901 (citations omitted).

305. Justice Stevens' dissent in *Lucas* criticized the majority test because it was too arbitrary and resulted in the problem illustrated by the above question. *Id.* at 2919. "A landowner whose property is diminished in value 95% recovers nothing, while an owner whose property is diminished 100% recovers the land's full value." *Id.* The majority responded by stating that:

It is clear by now that takings jurisprudence has been inconsistent at best. The emphasis evolved from a public benefit analysis to an economic analysis, with each tempered by an effort to strike a fair balance between the public and private interests.

## 2. Do Inclusionary Housing Provisions Constitute Takings?

Developers would most likely challenge the provisions in the Proposed MIHO, or in any inclusionary housing program for that matter, which require them to produce a specified percentage of units for very low-, low-, and moderate-income households.<sup>306</sup> The challenge would be based on the rationale that such requirements would cause developers to lose money. In spite of the muddled state of takings jurisprudence, based on historical takings law, modern trends, and the current composition of the Court, I predict that these types of

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This analysis errs in its assumption that the landowner whose deprivation is one step short of complete is not entitled to compensation. Such an owner might not be able to claim the benefit of our categorical formulation, but, as we have acknowledged time and again, "[t]he economic impact of the regulation on the claimant and . . . the extent to which the regulation has interfered with distinct investment-backed expectations" are keenly relevant to takings analysis generally. . . . It is true that in at least *some* cases the landowner with 95% loss will get nothing while the landowner with total loss will recover in full. But that occasional result is no more strange than the gross disparity between the landowner whose premises are taken for a highway (who recovers in full) and the landowner whose property is reduced to 5% of its former value by the highway (who recovers nothing). Takings law is full of these "all-or-nothing" situations.

*Id.* at 2895 n.8 (alteration in original) (citations omitted). Thus, the majority indicated that loss of a substantial portion of property short of a 100% loss is a rare case. *Id.* In fact, it is probably rare that people lose 100% of property use and much more likely that they lose a substantial portion of their property. As no categorical rule is available at such point, we resort to the balancing test between public and private interests with the usual reference to relevant factors.

The most recent landmark regulatory takings case, *Dolan v. City of Tigard*, 1994 WL 276693 (U.S. June 24, 1994), established a new wrinkle to the *Nollan* test. Recall that under *Nollan*, there must be a nexus between a land use regulation or condition and a social harm that the condition is intended to ameliorate. *Dolan*, 1994 WL 276693, at \*5-6. In *Dolan*, the City of Tigard conditioned issuance of a building permit on the applicant's dedication of a portion of her property to the city in order to alleviate harm which the building project might cause. *Id.* at \*3. The Supreme Court held that if the condition was not "roughly proportional" to the harm that the condition was designed to offset, then the applicant should be compensated for any loss caused by complying with the condition. *Id.* at \*8.

Thus, *Dolan* modified the *Nollan* test by requiring courts to determine not only whether an essential nexus exists between a legitimate state interest and a condition to development. In addition, if such a nexus exists, courts must also decide whether there is a roughly proportional "connection between the exactions and the projected impact on the proposed development." *Id.* at \*5.

306. See, e.g., Proposed MIHO, *supra* note 14, § 65853.7(a)(2)(A).

provisions would survive a takings challenge.

The takings test to be applied to a challenge of this nature would depend on a number of factors. Due to the uncertainty in this area, it is prudent to analyze a takings challenge to inclusionary housing considering components of all the takings tests.

It is unlikely that a court would make a ruling based solely upon the "character of the regulation" test, but it is still a factor which a court would consider. Provisions requiring an affordable housing set-aside could be enacted pursuant to the police power on the grounds that states (and by extension cities and counties) are responsible for the health, safety, and welfare of their residents. Since the provision of housing, especially sorely needed affordable housing, is unquestionably related to that power, the enactment of these provisions would be in the purview of a state or local government's police power.<sup>307</sup>

A court would also look at whether set-aside provisions cause an impacted party to suffer severe financial hardship.<sup>308</sup> This requires balancing a regulation's prevention of harm *or* grant of public benefits against the regulation's economic impact. Set-aside provisions clearly do not prevent nuisance-like activity, but they certainly grant a public benefit by providing affordable housing.<sup>309</sup> Against this benefit, a court weighs the financial impact on a private party.<sup>310</sup> This is hard to measure in the abstract without knowing the specific details of an ordinance and the actual financial impact on a development project.<sup>311</sup> If a developer could have earned reasonable profits by taking advantage of all available incentives, a court would expect the developer to do so and would still find the scales tipping in favor of the public interest. A trickier question arises when a developer has taken advantage of all incentives and still merely breaks even or actually loses money. If there is some viable economic use of the

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307. See Lawrence Berger, *A Policy Analysis of the Taking Problem*, 49 N.Y.U. L. REV. 165 (1974) (noting that land use has continually been regulated by zoning and other "police power devices").

308. See, e.g., *Pennsylvania Coal v. Mahon*, 260 U.S. 393 (1922).

309. Note that under *Mugler*, if a regulation only granted a public benefit without preventing harm, it would be a compensable taking. *Mugler v. Kansas*, 123 U.S. 623, 661 (1887).

310. See, e.g., Berger, *supra* note 307, at 175-76 (asserting that if all or substantially all of the value of the property is destroyed as a result of the government act, compensation must be paid).

311. The *DeBenedictis* Court implied that facial challenges generally will not be successful given the need for a factual context in takings cases. *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 495-97 (1987).

land, a court would uphold the regulation. However, if land is zoned only for residential use and any developer would lose money by complying with set-aside provisions, a court might invalidate the regulation.<sup>312</sup>

Under *Penn Central*, a court would also look at a regulation's economic impact.<sup>313</sup> This requires a court to first define the regulated property interest. Most courts will look at the entire bundle of rights, not merely one stick in the bundle.<sup>314</sup> If the private interest earns a reasonable rate of return on its entire bundle of property rights, this factor will weigh in favor of the public interest.<sup>315</sup> However, if the private interest cannot earn reasonable profits, this factor will weigh in favor of the private interest. Nonetheless, if the private property owner can make some other land use which would produce a reasonable rate of return, this factor would weigh in favor of the public interest.<sup>316</sup> Depending on how the other factors tip the scale, compensation could be ordered.

According to *Penn Central*, a court would also analyze a regulation's interference with investment-backed expectations. This factor is difficult to measure. How do you determine a party's reasonable, investment-backed expectations? Expectations may be reasonable if in accord with existing law when the expectations were developed. Timing is also significant—was the regulation enacted before or after

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312. A court could not modify the regulation but in a decision invalidating the regulation, it could provide suggested modifications so that it would pass constitutional muster. Note that a court would not order compensation to a private party in a facial challenge because it would be very difficult to measure damages prior to actual development. If an as-applied challenge arose following development and a court determined that in order to comply with the regulation, a developer would at best break even and otherwise lose money, it would probably find that the private party should be compensated.

313. *Penn Central*, 438 U.S. at 124.

314. *See, e.g., DeBenedictis*, 480 U.S. at 497. For example, if a developer owns 100 acres and is proposing a three phase development, one phase of which will contain most of the below market rate units, one phase which includes no such units, and one phase which contains some below market units, a court will look at the entire development rather than segmenting it into discrete phases.

315. So if a developer still earns reasonable profits in complying with set-aside requirements, the challenged provision would be upheld.

316. A mere diminution in value is inadequate in and of itself to prove that a regulation constitutes a taking. Normally, a regulation must deny the private interest *all* economically viable land use. *See, e.g., Agins v. City of Tiburon*, 447 U.S. 255, 260-63 (1980). It is unlikely that any inclusionary housing program would deny an owner or developer all economically viable land use. With the incentives offered in most programs, a developer should be able to profitably build a residential development. Furthermore, an owner or developer may make alternate land uses or can sell raw land.

a developer purchased land and made development plans? Were there public hearings concerning inclusionary housing regulations before development plans were underway? Did the developer spend a substantial amount of time and money in pre-development activities prior to enactment of the regulations?

If a developer was aware of set-aside requirements but continued developing anyway, then the developer's investment-backed expectations would have been shaped by that information and this factor would weigh in favor of the public interest.<sup>317</sup> If, however, a developer was already well underway in development plans when a challenged regulation was first proposed and later enacted, the developer's investment-backed expectations would probably anticipate profitability. In that case, this factor would weigh in favor of the private interest.<sup>318</sup> Residential developers are probably aware of the Proposed MIHO,<sup>319</sup> including its set-aside requirements, and it is a matter of public record that a statewide inclusionary housing program is being considered. If the Proposed MIHO is enacted, all California developers will thereafter be on notice and their investment-backed expectations will be formed accordingly.<sup>320</sup> Existing landowners who become subject to inclusionary housing mid-project may have a stronger argument that the requirement interferes with their reasonable investment-backed expectations.<sup>321</sup> The ultimate resolution depends on the

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317. For example, in *Ehrlich v. Culver City*, the developer purchased property aware of regulations restricting the property's use. 19 Cal. Rptr. 2d 468, 475 (Ct. App. 1993). The court denied the developer's takings claim, in part because "[t]he land-use restrictions on the property coincided with the developer's reasonable investment-backed expectations." *Id.*; see Berger, *supra* note 307, at 223-24.

If at the time of a detrimental act an owner of land knows or should know of plans for a government project and such a project is later completed, the government activity cannot constitute a taking of his property no matter how adversely it is affected thereby unless his land is physically invaded by the project.

*Id.*; see also William I. Gulliford III, Note, *The Effect of Notice of Land Use Regulations Upon Investment-Backed Expectations and Takings Challenges*, 23 STETSON L. REV. 201, 215 (1993) ("[A] landowner who was deprived of all economically viable use of property through the operation of an existing regulation could not claim a compensable taking since such use had been prohibited when the landowner obtained title to the property.").

318. Gulliford, *supra* note 317, at 215 ("In such an instance, the burden on the individual landowner is so great and unforeseeable that it 'should be borne by the public as a whole.'") (citations omitted); cf. Berger, *supra* note 307, at 174, 196.

319. See *supra* note 14.

320. Investment-backed expectations must at least be reasonable, and thus consistent with the law. "Consequently, a property owner's expectations are not protected when the property owner is on notice that an existing government regulation may limit expectations in the use and enjoyment of the property." Gulliford, *supra* note 317, at 219.

321. See *Penn Central*, 438 U.S. at 124-28.

fact specific inquiry that would accompany an as-applied challenge.

Under *Agins*, a court would look at whether a regulation furthers a legitimate state interest.<sup>322</sup> The provision of housing for every income group is certainly within the scope of the police power,<sup>323</sup> and California cities and counties in fact *must* provide housing plans for all income groups.<sup>324</sup> It thus follows that set-aside requirements which would effectuate the legitimate state interest of providing affordable housing, would be upheld.

*Nollan* requires a nexus between a legitimate state interest<sup>325</sup> and a challenged regulation. A nexus exists between the legitimate state interest of providing affordable housing and a regulation which requires, as a condition to development, that developers set-aside a percentage of their units as affordable housing. Nonetheless, it would be appropriate to compensate out of pocket losses (but not lost profits) resulting from set-aside requirements if they further a legitimate public interest, but there is no nexus between the requirement and the actions of the group impacted by the requirement. The rationale is that the need for the benefit is *not* caused by the developer's actions. If the need for the public benefit *is* caused by the developer's actions (i.e., new development draws new people of all classes, including lower income people, who will need affordable housing), then there is a direct nexus and the developer should internalize the losses.<sup>326</sup>

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322. See *supra* notes 275-82 and accompanying text.

323. See, e.g., *supra* text accompanying notes 41-43.

324. *Id.*

325. As already noted, there is a legitimate state interest in providing housing for all of a state's residents. See *supra* notes 323-24 and accompanying text.

326. It is questionable whether development of residential housing creates a need for affordable housing. MALLACH, *supra* note 14, at 169. There is a much stronger argument that commercial development is more likely to create such a need because the job base would create a need for affordable housing. In *Commercial Builders of N. California v. Sacramento*, 941 F.2d 872 (9th Cir. 1991), the court looked at the constitutionality of an ordinance which conditioned commercial development on the payment of fees to be used for low-income housing (low-income workers would be attracted as the result of such development). The court held that there was no taking because the ordinance:

was enacted after a careful study revealed the amount of low-income housing that would likely become necessary as a direct result of the influx of workers that would be associated with the new nonresidential development. . . . The burden assessed against the developers thus bears a rational relationship to a public cost closely associated with such development.

*Id.* at 874. Thus, the court upheld a low-income housing fee because there was a nexus between commercial development, a legitimate public interest, and the regulation. It also stated that "*Nollan* holds that where there is no evidence of a nexus between the development and the problem that the exaction seeks to address, the exaction cannot be upheld." *Id.*



This issue can be avoided altogether if set-aside requirements are countered with incentives, which if taken advantage of, would be adequate to allow developers to earn reasonable profits.<sup>327</sup>

Under *Lucas*, a court would look initially at whether a regulation deprives property owners of all economically viable land use.<sup>328</sup> If no economic value remains, the owner must be compensated *unless* the regulation is based on antecedent common law property and nuisance principles.<sup>329</sup> It is unlikely that set-aside requirements would deprive developers of all economic value of their land. They may, however, cause a diminution in value. As such, they would still survive the less stringent *Lucas* test.<sup>330</sup>

In addition to the tests culled from significant takings cases, it is important to note general trends and policies that may affect the outcome under a developer's takings challenge to set-aside requirements. A recent trend in takings cases subordinates important public interests to private property interests, thus giving greater weight to the private interest side of the scale as evidenced by *Nollan*, *Lucas* and *Dolan*. The public interest served by a regulation may be secondary to the private interest, particularly if economic use is diminished, coupled with disappointment of *reasonable* investment-backed expectations. This is a fair result as it has been conceded that the takings clause was originally developed to prevent

the public from loading upon one individual more than his just share of the burdens of government, and says that when he surrenders to the public something more and different from that which is

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at 875. Accordingly, so long as there is some evidence of a nexus, the regulation would be upheld.

327. For examples of common incentives, see *supra* text accompanying notes 69-70.

328. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886, 2893-94 (1992).

329. *Id.* at 2901-02.

330. Finally, under *Dolan*, once a court finds the requisite *Nollan* nexus, it still has to determine that there is a rough proportionality between the required condition and the proposed development. *Dolan*, 1994 WL 276693, at \*8 (U.S. June 24, 1994). While *Dolan* dealt with environmental harm, an analogous question that may arise under inclusionary housing is whether set-aside requirements are roughly proportional to the impact on a city or county having less land available overall for housing as a result of proposed development. Cities and counties should be able to argue that if there is an affordable housing shortage (which is true in most California cities and counties), construction of additional housing would intensify the problem if affordable housing was not provided for in the construction plans. Accordingly, the condition that some housing be available to low- or moderate-income persons would be roughly proportional to the affordable housing crisis. (Of course, the actual set-aside requirements would have to be reasonable under the circumstances, otherwise the "rough proportionality" requirement is not met.)

exacted from other members of the public, a full and just equivalent shall be returned to him.<sup>331</sup>

In summary, takings analysis has shifted from the earliest case law which broadly construed state police power in upholding regulations for the public good,<sup>332</sup> to a greater emphasis on preserving economic viability,<sup>333</sup> including greater Court willingness to expand private property rights and review land use regulations with greater scrutiny.<sup>334</sup> For the reasons set forth above, a court would not invalidate set-aside requirements under a facial challenge so long as an inclusionary housing program specified the purpose of the regulation, how that purpose related to a legitimate state interest, and how it contained adequate incentives to allow a developer to earn reasonable profits. However, in an as-applied challenge, a court should order compensation if a developer did not contribute to the need for the ordinance and could not comply with the ordinance without losing money.

### 3. Rent Control

Apartment owners or inclusionary unit owners might challenge rent control restrictions within inclusionary housing programs on the ground that they are takings. The rationale would be that restricting maximum rental income, rather than allowing costs and the market to determine rental rates, constitutes a taking.

In *Pennell v. City of San Jose*,<sup>335</sup> the Court reviewed a challenged rent control ordinance. In upholding the ordinance, the Court held that even if it caused a diminution in property value, “[s]tates have broad power to regulate housing conditions in general and the

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331. *Monongahela Navigation Co. v. United States*, 148 U.S. 312, 325 (1893).

332. *See, e.g., Hadacheck v. Sebastian*, 239 U.S. 394 (1915); *Mugler v. Kansas*, 123 U.S. 623 (1887).

333. *See, e.g., Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104 (1978); *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922).

334. *See, e.g., Lucas v. South Carolina Coastal Council*, 112 S. Ct. 2886 (1992); *Nollan v. California Coastal Comm'n*, 483 U.S. 825 (1987); *Dolan v. City of Tigard*, 1994 WL 276693 (U.S. June 24, 1994).

335. 485 U.S. 1 (1988). In this case, a landlord and apartment owners association challenged a rent control ordinance which allowed automatic annual rent increases of up to eight percent. *Id.* at 4-5. A landlord could raise rents by more than eight percent, but if a tenant objected to such an increase, a hearing would be scheduled. *Id.* at 5. Hearing officers would then determine whether the challenged increase was reasonable under the circumstances based on specific factors, including the hardship to the tenant. *Id.* The challenge was based on takings, due process, and equal protection grounds. *Id.* at 8-9, 11.

landlord-tenant relationship in particular without paying compensation for all economic injuries that such regulation entails.<sup>336</sup> Furthermore, the Court held that it was premature to consider a facial takings challenge, and would only consider an as-applied challenge.<sup>337</sup> Thus, pursuant to *Pennell*, a rent control takings challenge would only be heard on an as-applied basis.

Rent control restrictions in inclusionary programs can be analogized to similar restrictions in the mobile home context. In *Yee v. City of Escondido*,<sup>338</sup> mobile home park owners claimed that local rent control laws constituted a *physical taking* insofar as they transferred an economic right from park owners to mobile home owners.<sup>339</sup> The Court ruled only on the physical takings issue,<sup>340</sup> even though the regulatory taking issue was ripe for adjudication.<sup>341</sup> However, in discussing regulatory takings generally, it stated that:

compensation is required only if considerations such as the purpose of the regulation or the extent to which it deprives the owner of the economic use of the property suggest that the regulation has unfairly singled out the property owner to bear a burden that should be borne by the public as a whole.<sup>342</sup>

Under dicta in *Yee*, if a rent control regulation is based on a questionable purpose or unfairly singles out a particular property owner or

336. *Id.* at 12 n.6 (quoting with approval *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 440 (1982) (citations omitted)).

337. *Id.* at 9-10. It stressed that in takings challenges, the validity of a challenged regulation should only be decided in the context of an actual factual setting. *Id.*

338. 112 S. Ct. 1522 (1992).

339. *Id.* at 1527-28. While state laws generally regulate mobile home parks, they do not limit rents. *See, e.g.*, CAL. CIV. CODE §§ 798-799.79 (West 1982 & Supp. 1995). In this case, the challenged local ordinance which was approved in 1988, set rents back to their 1986 rates and only allowed rent increases with the City Council's approval. *Yee*, 112 S. Ct. at 1527. Plaintiffs argued that a mobile home's value was enhanced by both state laws which gave the home owner the right to occupy the pad indefinitely, and local laws which granted protection via rent controls. *Id.* at 1528. In other words, a mobile home owner could leave the home at the park indefinitely at controlled rents. This is a valuable right for mobile home owners because purchasers will pay a premium for homes in parks subject to rent control. Home owners thus may benefit, but a park owner cannot profit. *See id.*

340. The Court held that the ordinance did not amount to a physical taking because it did not authorize an unwanted physical occupation—plaintiffs voluntarily rented pads to mobile home occupants. *Id.* at 1528.

341. *Id.* at 1531-34. The regulatory issue was not included in the petition for certiorari. *Id.* at 1533. "[W]ere we to address the issue here, we would apparently be the first court in the nation to determine whether an ordinance like this one effects a regulatory taking." *Id.* at 1534.

342. *Id.* at 1526 (dictum) (citations omitted).

a particular class of property owners, the regulation might be deemed a taking.

The rent control restrictions in the Proposed MIHO were designed to preserve affordability,<sup>343</sup> a recognized valid purpose.<sup>344</sup> In *Casella*, the court determined that the purpose of a challenged mobile home rent control ordinance was "to control excessive rental prices for the largely fixed-income residents of mobile home parks."<sup>345</sup> It held that such purpose was a legitimate interest that could be effectuated through the state's police powers.<sup>346</sup> Since the rent control ordinance was reasonably related to the promotion of a valid state interest, the court granted deference to the legislature and upheld the ordinance.<sup>347</sup> By extension, rent control restrictions in the inclusionary housing context are also established pursuant to a valid purpose which falls within the state's police power, and accordingly should be upheld.

Under the second part of the *Yee* test, it is unlikely that challengers could successfully prove that they had uniquely suffered an economic loss for two reasons. Most importantly, rent control provisions are designed to allow a reasonable rate of return, thus, no loss should be incurred.<sup>348</sup> Second, since rent control provisions apply

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343. In addition to providing affordable housing, the proposed MIHO intends to "[s]et standards for the availability of affordable ownership and rental housing opportunities in all new residential developments, while at the same time providing a combination of regulatory reforms and incentives that offset increased costs of complying with the standards." Proposed MIHO, *supra* note 14, § 65853.5(c)(3).

344. *Casella v. City of Morgan Hill*, 280 Cal. Rptr. 876, 884-85 (Ct. App. 1991), *rev. denied*, 1991 U.S. Dist. LEXIS 3294 (1991), *dismissed*, 1991 U.S. Dist LEXIS 14,904 (N.D. Cal. 1991), *cert. denied*, 112 S. Ct. 1665 (1992).

345. *Id.* at 884.

346. *Id.* at 884-85.

347. *See id.*; *see also* *Candlestick Properties, Inc. v. San Francisco Bay Conservation and Dev. Comm'n*, 89 Cal. Rptr. 897 (Ct. App. 1970):

It is a well settled rule that determination of the necessity and form of regulations enacted pursuant to the police power is primarily a legislative and not a judicial function, and is to be tested in the courts not by what the judges individually or collectively may think of the wisdom or necessity of a particular regulation, but solely by the answer to the question is there any reasonable basis in fact to support the legislative determination of the regulation's wisdom and necessity?

*Id.* at 905 (citations omitted).

348. So long as a party subject to price controls is allowed a reasonable rate of return, the control will not be deemed confiscatory. *See, e.g.*, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (holding that rates established by the Commission for natural gas were just and reasonable); *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 581-82 (1942) (same).

uniformly to all property owners subject to inclusionary housing, no particular landowners are singled out to bear a greater burden. So long as rent control restrictions apply uniformly to all new rental properties in areas subject to inclusionary housing *and* allow a property owner to earn a reasonable investment return, this challenge would fail.

### B. Fourteenth Amendment Challenges

Developers, market rate home owners in developments subject to inclusionary housing, and inclusionary unit owners may challenge various aspects of inclusionary housing programs on due process and equal protection grounds. The challenges would be based on the unreasonableness or arbitrariness of inclusionary housing, or the disparate impact of inclusionary housing on select groups. The Fourteenth Amendment of the U.S. Constitution provides in part that no state shall "deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."<sup>349</sup> Similarly, the California Constitution provides that "[a] person may not be deprived of life, liberty, or property without due process of law or denied equal protection of the laws."<sup>350</sup>

A Fourteenth Amendment claim thus challenges the rationality or fairness of the regulatory process. Impacted parties could contest either the facial validity of a regulation as generally unconstitutional, or a regulation's constitutionality as applied to a particular parcel of land.<sup>351</sup> The proper remedy under facial claims would be to strike down the challenged regulation.<sup>352</sup> As-applied violations would warrant injunctive relief and possibly damages for any unconstitutional application.<sup>353</sup> While the tests for the two types of claims are somewhat different under the due process and equal protection clauses, they are frequently applied interchangeably so the analysis of the two clauses cannot always be clearly broken down into one or the other.

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349. U.S. CONST. amend. XIV, § 1.

350. CAL. CONST. art. I, §7(a).

351. See *Pennell v. City of San Jose*, 485 U.S. 1, 10-12 (1988); *Eide v. Sarasota County*, 908 F.2d 716, 725-26 (11th Cir. 1990) (distinguishing an as-applied challenge from a facial one by noting that the former only becomes ripe for adjudication when a "decision . . . [has been] finally made and applied to the property," but the latter is ripe after passage of the regulation), *cert. denied*, 498 U.S. 1120 (1991).

352. *Eide*, 908 F.2d at 722.

353. *Id.*

Thus, while I treat them separately, there is conceptual overlap of the clauses.

### 1. Due Process

#### a. Procedural Due Process

Various components of the Proposed MIHO may violate either procedural or substantive due process. Procedural due process requires that a party receive notice and an opportunity to be heard prior to being deprived of a significant interest involving life, liberty, or *property*.<sup>354</sup>

In a land use context, to the extent that governmental actions generally affect all property owners equally, the government need not give property owners actual notice and an opportunity to be heard.<sup>355</sup> However, if a relatively small number of people are affected by a regulation, the failure to provide those individuals with notice and an opportunity to be heard constitutes a denial of procedural due process.<sup>356</sup> Procedural due process thus attempts to mitigate government actions with potentially harmful effects on an impacted group's use of property by requiring that the impacted group be given adequate notice and an opportunity to be heard before being legally bound by such action. In order to state a claim under procedural due process, impacted parties must establish that: the government action was the type to which due process applies; they had a protected property interest; and that the protected interest was diminished or removed without the process due under the circumstances.<sup>357</sup>

It is unlikely that the Proposed MIHO would be challenged on procedural due process grounds because as a state law,<sup>358</sup> it will ap-

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354. *Armstrong v. Manzo*, 380 U.S. 545, 550, 552 (1965) (citations omitted).

355. *See, e.g., Nasierowski Bros. Inv. Co. v. City of Sterling Heights*, 949 F.2d 890, 896 (6th Cir. 1991); *Harris v. County of Riverside*, 904 F.2d 497, 501-02 (9th Cir. 1990).

356. *Harris*, 904 F.2d at 501-02.

357. *Id.* at 501; *see also Nasierowski Bros.*, 949 F.2d at 897 (citing *Trever v. City of Sterling Heights*, 218 N.W.2d 810, 812 (Mich. Ct. App. 1974)) (stating that a landowner may also establish a protected property right by undertaking substantial action in reliance on zoning in existence at the time the actions were undertaken, such that a zoning change would substantially and detrimentally impact the property owner); *Bateson v. Geisse*, 857 F.2d 1300, 1305 (9th Cir. 1988) (holding that in order to establish a property right subject to due process protection, a landowner's existing property interest must arise through an independent source such as a federal or state law).

358. The California legislature can only make law by statute, which must be enacted by a bill. A bill may only be passed if it is read by title on three days in each house (subject to exception if two-thirds of the membership concur in a rollcall vote). Furthermore, no bill may be passed until the bill, with any amendments, has been distributed in print to each

ply equally to similarly situated property owners or developers. For the same reason, local inclusionary housing programs that apply equally to similarly situated property owners or developers, would also survive a procedural due process challenge. Furthermore, local ordinances, at least in California, would be subject to an intense notice and hearing process pursuant to state law requirements.<sup>359</sup> California state law and local ordinance enactment procedures would satisfy procedural due process requirements. Thus, it is unlikely that a claim would arise, much less succeed, on procedural due process grounds.

#### b. Substantive Due Process

Government action that infringes upon rights traditionally associated with property ownership, such as use and development, violates substantive due process when the action is "clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare."<sup>360</sup> In *Euclid*, the Court cautioned that in deciding issues arising under the due process clause, courts should take a case by case approach in applying and extending constitutional principles, rather than establishing general rules to which future cases must be fitted.<sup>361</sup> Thus, while there are some general guidelines for handling a due process challenge, there is no bright-line rule for determining whether regulations violate substantive due process rights.

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member, and until a majority of the membership of each house concurs by a rollcall vote. CAL. CONST. art. IV, § 8(b).

359. See generally CAL. GOV'T CODE §§ 50020-50022.10 (West 1994). These sections provide generally that public hearings must be held prior to adoption of an ordinance, and that notice of such hearings must be published in advance. The notice must include the time and place of the hearing, as well as a description of the purpose of the ordinance and its subject matter. CAL. GOV'T CODE § 50022.3 (West 1994).

360. *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 395 (1926) (citations omitted); see *Sinaloa Lake Owners Ass'n v. City of Simi Valley*, 882 F.2d 1398, 1407 (9th Cir. 1989); *Nash v. City of Santa Monica*, 688 P.2d 894, 899 (Cal. 1984); see also *Bateson v. Geisse*, 857 F.2d 1300 (9th Cir. 1988). In *Bateson*, the court held that a city council's decision to withhold a building permit, even though the applicant had fully complied with all conditions to the issuance of the permit, violated the applicant's due process rights. See *id.* at 1303. Because this was a substantive due process claim, the applicant did *not* have to prove that he had been deprived of all economically viable use of his property. The test instead was whether the city council's interference with the applicant's property rights was irrational or arbitrary and capricious. *Id.* Thus, unreasonableness of governmental action is an adequate basis to strike down the action.

361. *Ambler Realty*, 272 U.S. at 397.

Impacted developers could challenge the Proposed MIHO as being arbitrary or unreasonable because it requires residential developers to provide housing affordable to low- and moderate-income families as a condition to development approval.<sup>362</sup> The Proposed MIHO thus charges a premium of sorts to new housing developers, freeing former developers and government, among others, from an obligation to provide affordable housing. Impacted developers would argue that this is especially unfair because they are not solely, or even primarily, responsible for the affordable housing crisis. In *Associated Home Builders, Inc. v. City of Walnut Creek*,<sup>363</sup> the plaintiffs made a similar argument, contending that the challenged ordinance arbitrarily applied only to subdividers, and not to apartment developers.<sup>364</sup> While the court acknowledged the merit of plaintiffs' argument, it did not invalidate the ordinance on due process grounds because there were adequate distinctions to justify disparate legislative treatment of the two types of developers.<sup>365</sup> Government entities which enact inclusionary housing programs could likewise successfully argue that there are sufficient reasons for treating impacted developers differently. For example, the Proposed MIHO only applies to developers of a minimum number of units.<sup>366</sup> Part of the rationale behind this minimum number is that it promotes the production of inclusionary units while still allowing profitability.<sup>367</sup>

Developers could also argue that the Proposed MIHO is arbitrary because it selects a random number of inclusionary units to be pro-

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362. See Proposed MIHO, *supra* note 14, § 65853.7(a)(2)(A).

363. 484 P.2d 606 (Cal. 1971).

364. See *id.* at 614. This case involved a state statute which allowed a city or county to require land dedication or payment of an in-lieu fee for park and recreational purposes, as a condition to subdivision map approval. See *id.* at 608. The City of Walnut Creek enacted legislation which implemented the state statute. *Id.* It provided in part that:

two and one-half acres of park . . . must be provided [by a subdivider] for each 1,000 new residents. If, however, no park is designated on the master plan and the subdivision is within three-fourths of a mile radius of a park or a proposed park, or the dedication of land is not feasible, the subdivider must pay a fee equal to the value of the land which he would have been required to dedicate under the formula.

*Id.* at 609. Plaintiffs challenged each of the state and city statutes. *Id.* at 608.

365. See *id.* at 614. The court noted that "[t]he Legislature could reasonably have assumed that an apartment house is . . . ordinarily constructed upon land considerably smaller in dimension than most subdivisions . . . This significant distinction justifies legislatively treating the builder of an apartment house who does not subdivide differently than the creator of a subdivision." *Id.*

366. See Proposed MIHO, *supra* note 14, § 65853.7(a)(1).

367. See *supra* note 106 and accompanying text.



duced.<sup>368</sup> This argument would fail because the Proposed MIHO requires that a feasibility study be performed which determines both the income levels served by the ordinance, and a fair percentage of required inclusionary units, taking into account the need for both profitability and affordable housing.<sup>369</sup> Because the percentage of required inclusionary units is calculated by determining a maximum number of units that can profitably be built without public subsidies,<sup>370</sup> the MIHO formula for determining the number of units is clearly not arbitrary or irrational. And again, judicial deference to legislative action would weaken a challenger's position.<sup>371</sup>

Apartment owners and inclusionary unit owners subject to rent control restrictions, could challenge those restrictions on the ground that they violate substantive due process. In addressing substantive due process claims in a rent control context, the Court in *Pennell v. City of San Jose*<sup>372</sup> stated that "[t]he standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well established: 'Price control is "unconstitutional . . . if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt.'"<sup>373</sup> The Court also acknowledged a government's general right to interfere in a marketplace via price control mechanisms, to alleviate a "discrepancy between supply and demand in the market for a certain product."<sup>374</sup>

Applying the *Pennell* standard to the Proposed MIHO, the first question is whether the rent control restrictions are arbitrary or "demonstrably irrelevant to the policy the legislature is free to adopt."<sup>375</sup> This hurdle would be practically insurmountable to a challenging party. First, it would be difficult to prove that rent control provisions are arbitrary because they are designed to preserve

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368. See Proposed MIHO, *supra* note 14, § 65853.7(a)(2)(A)-(B).

369. See *id.*

370. See *id.*

371. See *supra* note 347 and accompanying text.

372. 485 U.S. 1 (1988).

373. *Id.* at 11 (citations omitted).

374. *Id.* at 12. In *Pennell*, there was a discrepancy between the existing housing supply and the great demand for housing, especially low-income housing. See *id.* The parties to this action acknowledged the validity of the ordinance's purpose, which was "alleviat[ing] some of the more immediate needs created by San Jose's housing situation" by preventing "excessive and unreasonable rent increases" caused by the "growing shortage of and increasing demand for housing in the City of San Jose." *Id.* at 4, 12 (quoting SAN JOSE, CAL., MUN. ORDINANCE § 5701.2 (1979) (amended by ch. 17.23.020) (alteration in original)).

375. *Id.* at 11.

inclusionary units, with actual rental rates based on studies which balance the goals of preserving affordability with maintaining reasonable profits. Second, rent control provisions are clearly relevant to the policy of providing and retaining affordable housing. Housing policy, therefore, is clearly included within those policies which legislatures are free to adopt. Thus, a court would not find the Proposed MIHO's rent restrictions to be arbitrary or unreasonable, nor would the restrictions violate substantive due process.

The potential challenges under the "reasonable and arbitrary" portion of the substantive due process clause are all relatively weak. They would be insufficient to strike down the above-discussed provisions in the Proposed MIHO, considering its findings and well-reasoned policy statement,<sup>376</sup> and the valid purposes behind the provisions.

Another way to attack the Proposed MIHO on substantive due process grounds is to establish that it is beyond the police power, or that there is no nexus between it and the police power.<sup>377</sup> The provision of affordable housing is clearly within the police power because it protects the health, safety, and welfare of citizens by providing them with shelter opportunities.<sup>378</sup> However, that does not mean that any method is permissible to reach such end. Nonetheless, because the principal purpose of the Proposed MIHO and of inclusionary housing generally, is to provide housing affordable to very low-, low-, and moderate-income families, and the provision of housing is within the scope of the police power, there is a clear and direct nexus between inclusionary housing and the police power. Finally, in determining the relationship between an ordinance and the police power, courts generally defer to the legislature.<sup>379</sup> Accordingly, a challenge under this part of the substantive due process clause also would fail.

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376. See Proposed MIHO, *supra* note 14, § 65853.5.

377. See *Associated Home Builders, Inc. v. City of Walnut Creek*, 484 P.2d 606, 610-13 (Cal. 1971); Fox & Davis, *supra* note 20, at 1029.

378. See Fox & Davis, *supra* note 20, at 1029-30.

If local governments may require slum rehabilitation, preservation of historical sites and natural areas, clustering of structures to maintain open space, mixture of land uses within zones, exactions of land as a condition of permit approval, and granting of tax preferences to preserve agricultural lands, then construction of low and moderate cost housing logically falls within the permissible exercise of the police power.

*Id.* (footnotes omitted).

379. See *supra* note 347 and accompanying text.

There is no evidence that the Proposed MIHO is either arbitrary, capricious or unreasonable. To the contrary, it has been carefully designed to require production of a specific number of inclusionary units, with the actual number based on a feasibility analysis.<sup>380</sup> The final blow to a substantive due process challenge is that courts generally give judicial deference to legislative action.<sup>381</sup> Accordingly, unless an inclusionary housing program were drafted without findings, or without a policy statement describing the problems which it aimed to address, or without a rational legislative purpose, it would be upheld.

## 2. Equal Protection

Courts use two general standards in reviewing challenges under the equal protection clause of the 14th Amendment: "strict scrutiny" and "rational basis." The "strict scrutiny" standard is utilized in reviewing regulations that affect certain recognized suspect categories (i.e., race) and fundamental interests<sup>382</sup> (i.e., right of free speech). Under a strict scrutiny standard, the government must demonstrate both that a challenged regulation has been narrowly drawn and that it furthers a compelling interest.<sup>383</sup> A challenging party under this standard has a reasonable chance of victory because of the government's heavy burden. Under the rationality standard, a challenged regulation will be upheld if there is *any* rational basis for a regulation which affects "non-suspect" classes more than the general population.<sup>384</sup> While some housing advocates have argued that the right to housing is a fundamental interest,<sup>385</sup> that argument has failed.<sup>386</sup> Economic regulations and land use regulations thus continue to be measured against the rationality standard.<sup>387</sup> The use of this standard has been

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380. See, e.g., Proposed MIHO, *supra* note 14, § 65853.7(a)(2)(A)-(B).

381. See *supra* note 347 and accompanying text.

382. See, e.g., *City of Cleburne v. Cleburne Living Ctr.*, 473 U.S. 432, 440 (1984); *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 61 (1973).

383. *Cleburne*, 473 U.S. at 440; *Griffin Dev. Co. v. City of Oxnard*, 703 P.2d 339, 343 (Cal. 1985) (holding that "where a zoning law or other land use regulation infringes upon a constitutionally protected personal liberty or fundamental right, 'it must be narrowly drawn and must further a sufficiently substantial government interest'" (citations omitted)).

384. *New Orleans v. Duke*, 427 U.S. 297, 303 (1976); *Eide v. Sarasota County*, 908 F.2d 716, 722 (11th Cir. 1990); *Fry v. City of Hayward*, 701 F. Supp. 179, 181 (N.D. Cal. 1988).

385. See *supra* note 8 and accompanying text.

386. See *supra* note 9 and accompanying text.

387. See *Cleburne*, 473 U.S. at 440; *Schweiker v. Wilson*, 450 U.S. 221, 235 (1981); *Associated Home Builders, Inc. v. City of Livermore*, 557 P.2d 473, 485 (Cal. 1976);

justified because:

Most zoning and land use ordinances affect population growth and density. . . . As commentators have observed, to insist that such zoning laws are invalid unless the interests supporting the exclusion are compelling in character, and cannot be achieved by an alternative method, would result in wholesale invalidation of land use controls and endanger the validity of city and regional planning.<sup>388</sup>

Parties attacking inclusionary housing on equal protection grounds must prove that the ordinance is discriminatory and not rationally related to a legitimate state interest. This is a heavy burden which is rarely met because of the general rule that "legislation is presumed to be valid and will be sustained if the classification drawn by the statute is rationally related to a legitimate state interest."<sup>389</sup>

a. Developers

In the land use context, courts might find a classification to be discriminatory if similarly situated parcels are treated differently.<sup>390</sup> Developers could challenge inclusionary housing under the equal protection clause because it requires some, but not all, developers to build affordable housing. Inclusionary housing therefore singles out certain developers to bear the cost of a community-wide problem. For example, under the Proposed MIHO, only developers of new residential developments consisting of a minimum of ten units are required to build inclusionary units.<sup>391</sup> This argument would probably fail because *all* developers of projects containing the minimum unit requirements are required to produce inclusionary units. While commercial developers or developers of projects containing fewer than the requisite number of units may not be subject to inclusionary housing requirements, they are not situated similarly (because of the difference in project types or size). The distinctive treatment is thus justified because similarly situated developers are in fact treated similarly.

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Remmenga v. California Coastal Comm'n, 209 Cal. Rptr. 628, 630 (Ct. App. 1985); Fox & Davis, *supra* note 20, at 1033.

388. *Associated Home Builders*, 557 P.2d at 485 (citations omitted).

389. *Cleburne*, 473 U.S. at 440 (noting that "when social or economic legislation is at issue, the Equal Protection Clause allows the States wide latitude . . . and the Constitution presumes that even improvident decisions will eventually be rectified by the democratic processes" (citations omitted)).

390. *Southern Pac. Co. v. Los Angeles*, 51 Cal. Rptr. 197, 203-04 (Ct. App. 1966).

391. *See supra* text in first full paragraph following note 105. This section of the Proposed MIHO also specifies exceptions to the construction requirement.

Developers could also argue that inclusionary requirements discriminate against them because such requirements are tied to the need for affordable housing generally, and are not related specifically to developers' use of their land. This type of argument would be akin to the argument that exactions or dedications, which are not specifically tied to a development, violate equal protection. However, in discussing the validity of these types of conditions to development, a California court affirmed that:

[A] subdivider who was seeking to acquire the advantages of subdivision had the duty to comply with reasonable conditions for dedication so as to conform to the welfare of the lot owners and the general public. We held, further, that the conditions were not improper because their fulfillment would incidentally benefit the city as a whole or because future as well as immediate needs were taken into consideration and that potential as well as present population factors affecting the neighborhood could be considered in formulating the conditions imposed upon the subdivider.<sup>392</sup>

Accordingly, if development is conditioned on the construction of inclusionary units, such condition would be upheld so long as it was related to the project (even if it incidentally benefitted the overall geographic area's housing need, or took into consideration future needs). There is a compelling argument that in determining whether to approve a new project, a local government must take into consideration housing for all income categories. Thus, if there is a need for low-income housing, it is a reasonable condition to development that low-income housing be built (in the same way that development may be conditioned on the construction of schools, parks, and other improvements that may be needed).<sup>393</sup>

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392. *Associated Home Builders, Inc. v. City of Walnut Creek*, 484 P.2d 606, 610 (Cal. 1971).

393. Housing commentators analyzing a below market price ("bmp") unit program, argued that the program would withstand an equal protection attack for the following reasons:

If state law permits exactions for purposes of a general public need to which the development would contribute, a [below market price] requirement would not seem to deny equal protection. Local legislatures may determine that traditional residential projects tend to develop land, increase housing prices, create environmental problems, and fail to meet the need for low and moderate cost housing, all with the past implicit approval of the zoning authority. . . . [Certain types of] developments tend to accelerate these social problems, and local solutions, therefore, logically should begin with the largest contributors to the shortage of low cost housing.

Fox & Davis, *supra* note 20, at 1033. Under this rationale, inclusionary requirements could

### b. Inclusionary Unit Owners

Inclusionary unit owners could argue that resale restrictions single them out by limiting both their market of buyers and their sales price.

The rationality standard would apply and so long as the restrictions were rationally related to a legitimate state interest and were not unconstitutionally discriminatory, they would be upheld. As will be established in the section on restraints on alienation, resale restrictions are rationally related to the legitimate governmental purpose of preserving the stock of affordable housing.<sup>394</sup> It is unlikely that resale restrictions would be deemed unconstitutionally discriminatory for several reasons. First, they apply to all inclusionary unit owners.<sup>395</sup> Thus, no inclusionary unit owners are singled out for unfair treatment. Second, most resale restrictions allow an inclusionary unit owner to recover costs incurred in the purchase and upkeep of a unit, as well as to earn a reasonable rate of return on the unit.<sup>396</sup> Third, the restrictions at issue are the same type of restrictions which allowed an inclusionary unit owner to initially purchase a unit. Equity therefore dictates that it is fair and not discriminatory to uphold those restrictions with respect to subsequent sales of inclusionary units.

### c. Market Rate Occupants

Market rate unit owners can argue that inclusionary housing violates both substantive due process and equal protection clauses because it causes them to pay a premium for their units to the extent developers pass part of the cost of providing inclusionary units forward.<sup>397</sup>

As a starting point, it is far from certain that developers will pass costs on to market rate owners.<sup>398</sup> Accordingly, this argument

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be justified for developments which are more likely to contribute to the shortage of low cost housing, i.e., larger developments or developments which use scarce land in a high land cost area.

394. See *infra* part V.C.1.

395. See, e.g., *supra* text accompanying note 118.

396. See, e.g., *supra* text accompanying note 88.

397. "Most economists, builders and social planners agree . . . that any regulatory system that drives up builder costs in a housing market area will certainly result in an increase in housing prices for market home buyers in that area." Hill, *supra* note 183, at 14.

398. The incentives in most programs are designed to offset costs of providing inclusionary units. Theoretically, any costs incurred could be recouped through incentives such

is valid only if these home owners in fact pay a premium for their units. Even if some costs are passed on to market rate unit owners, the proportional cost of a market rate home attributable to inclusionary housing is uncertain.<sup>399</sup> Assuming some costs were passed on to market rate unit owners, a California court rejected a similar challenge that dedications or fees in-lieu thereof placed special burdens on future inhabitants of subdivisions.<sup>400</sup> The *Associated Home Builders* court stated that if it recognized the burdens placed on new inhabitants, it had to recognize the burden on existing and former inhabitants of paying for the purchase and maintenance of existing public facilities.<sup>401</sup> So, even if challengers could prove that they were unfairly impacted because they paid a premium for their units, they would not succeed under an equal protection claim because courts have recognized that some costs must be absorbed by residents of a new project.<sup>402</sup> Accordingly, an equal protection challenge by market rate unit owners would be rejected.

In sum, the inherent fairness and reasonableness of most inclusionary housing programs, and of the Proposed MIHO as evidenced by requisite feasibility studies, virtually ensure that the programs will be upheld. Studies indicate that programs are not adopted arbitrarily, and they demonstrate that careful thought goes into programs prior to their adoption.<sup>403</sup> Most programs also contain findings which explain a program's purposes, which purposes are generally tied to the legitimate state interest of providing affordable housing.<sup>404</sup> For these reasons, it is unlikely that either the Proposed MIHO or most inclusionary housing programs, would violate the

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as density bonuses and there would not be any costs to pass on to market rate owners. *See supra* notes 69-70 and accompanying text.

399. One source notes:

Because of the many expenses incurred by a developer, the cause of any increase in price can only be speculated upon. For example, dedication of land for roads, parks, schools, and other public facilities necessarily increases the developer's expenses, which are in turn passed on to the housing purchasers. Additional expenses for constructing [below market price] units fall within the same category of facilities provided for public objectives and benefiting the developer's land.

Fox & Davis, *supra* note 20, at 1034.

400. *Associated Home Builders, Inc. v. City of Walnut Creek*, 484 P.2d 606, 618 (Cal. 1971).

401. *Id.* at 613-14.

402. *Id.* at 614-16.

403. *See, e.g., NIMBY REPORT, supra* note 21.

404. *See, e.g., N.J. STAT. ANN.* § 55 (West 1989); *Monterey, Cal., Resolution 82-16* (Jan. 19, 1982); *MONTGOMERY, MD., CODE ch. 25A-1* (1988).

## Fourteenth Amendment Due Process or Equal Protection Clauses.

### C. Restraints on Alienation

This section explores whether restrictions on the sale of inclusionary units violate laws prohibiting restraints on alienation and contracts in restraint of trade or commerce, including price-fixing agreements. While the law generally disfavors these restraints, if they are reasonable under the circumstances, they are typically upheld.<sup>405</sup> Most restraints on alienation within inclusionary housing programs are reasonable and tend to be narrowly drawn in order to preserve alienability while retaining the stock of affordable housing.<sup>406</sup> Therefore, they would likely survive a challenge under this claim.

#### 1. Resale Controls

Resale controls, deed restrictions, and other restrictions on the transfer of inclusionary units, may be invalid as unreasonable restraints on use or alienation.<sup>407</sup>

The traditional rule against restraints on alienation is based on the public policy notion that the free alienability of property fosters economic and commercial development. However, almost from the inception of the rule, competing policy considerations have led to exceptions to the rule, with the validity of the restraint determined on the basis of the duration, type of alienation precluded or the size of the class precluded from taking. The modern view is to test the validity of the restraints by weighing the competing social policies.<sup>408</sup>

Before elaborating on the above balancing test, some restraints are not subject to the test and are thus generally upheld. There is a recognized exception to the rule against restraints on alienation under a preemptive right. In addition, the statutory requirement doctrine removes certain restraints from the application of the rule.

A preemptive right is an option to purchase, such as the first

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405. See, e.g., *City of Oceanside v. McKenna*, 264 Cal. Rptr. 275, 279 n.4 (Ct. App. 1989); *Housing Auth. v. Monterey Senior Citizen Park*, 210 Cal. Rptr. 497, 501 (Ct. App. 1985).

406. See, e.g., *City of Oceanside*, 264 Cal. Rptr. at 279 n.4.

407. CAL. CIV. CODE § 711 (West 1994) ("Conditions restraining alienation, when repugnant to the interest created, are void."); RESTATEMENT (SECOND) OF PROPERTY 142 (1983) ("The rule against direct restraints on alienation is older than the rule against perpetuities.")

408. *City of Oceanside*, 264 Cal. Rptr. at 279 n.4 (citations omitted).



rights to purchase commonly contained in resale restrictions. Options of this sort are generally upheld if "the terms of the right of first refusal are reasonable in regard to both the price that the designated person must pay, and the time allowed for the exercise of the right of first refusal."<sup>409</sup> Many inclusionary housing program purchase options designate a price based on factors which preserve affordability, while allowing a reasonable rate of return on an investment. These pricing formulas are carefully designed to allow an inclusionary unit owner to recover actual costs plus appreciation.<sup>410</sup> Thus, they are reasonable and equitable with respect to the price. The time period within which an option holder must exercise an option varies, with sixty days about average.<sup>411</sup> If an option is not exercised within that time period, it lapses (for purposes of that sale but will usually survive for a set number of years from the commencement of the inclusionary housing program). The time period is thus calculated to give an option holder a fair period of time to purchase a unit, while not unduly restricting an owner's right to sell the unit. The time allowed for exercise of an option is also, therefore, quite reasonable. Under the preemptive right exception, options as a resale control would thus be upheld.

The statutory requirement doctrine does not so much carve out an exception for restraints established pursuant to statute, but rather allows certain restrictions, even if they inhibit marketability. The rationale is that the common law rule against restraints on alienation applies to restraints in contracts, *not to restraints established by statute or operation of law*.<sup>412</sup> Thus, if California were to enact the Pro-

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409. RESTATEMENT (SECOND) OF PROPERTY § 4.4(b) (1983) (an illustration of acceptable restraints are "[p]reemptive provisions [which] are widely used in residential developments . . . to provide some control over the selection of persons who become neighbors in the residential area"); *see also* Housing Auth. v. Monterey Senior Citizen Park, 210 Cal. Rptr. 497, 501 (Ct. App. 1985) ("Option to Purchase Agreement" did not violate the restraint on alienation provisions when "the consideration for this option is the execution" of the lease.); 4 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW § 410 (9th ed. 1987) ("A condition that a grantee will not sell the estate without first offering it to the grantor or some other designated person is valid. This type of promissory restraint does not unreasonably inhibit alienation.") (citations omitted).

410. *See, e.g.*, Monterey, Cal., Resolution 90-12 (Jan. 16, 1990). The Monterey program provides that the purchase price shall be the lower of the market value or moderate income price. It defines moderate income price as the "[s]um of original sale price, annual consumer price index adjustments, and value of improvements authorized by the City, less costs to repair deficiencies identified through structural pest control/city inspection." *Id.*

411. *Id.*

412. RESTATEMENT OF PROPERTY, Part II Vol. IV (1944); 4 B.E. WITKIN, *supra* note

posed MIHO, any resale restrictions in the program would not be subject to the rule because the restraints would be established by statute.

With respect to resale restrictions in other inclusionary housing programs, since they may be enacted pursuant to California's housing element legislation,<sup>413</sup> there is a strong argument that they should be upheld under the statutory requirement rationale. Butressing this argument, the HCD's legal counsel reviewed deed restrictions in an earlier version of Orange County's inclusionary housing ordinance to determine whether they violated the policy against restraints on alienation. HCD opined that the restrictions fell within the statutory requirement exception because they were imposed by statute or rule of law.<sup>414</sup> While the HCD does not have the authority of a legislature or court, its opinion would likely influence a court. In addition, in California, one could argue that resale restrictions in inclusionary housing programs could be upheld under the statutory requirement rationale because the restraints are established by operation of law in order to comply with the housing element mandate.<sup>415</sup>

If one of the above exceptions did not apply to uphold resale restrictions, a court would then perform a balancing test. It would weigh the policy favoring free alienability against the social policy furthered by the restrictions, taking into consideration the reasonableness and duration of the restrictions (the longer the duration, the stronger the social policy justification must be to uphold it), the alienation precluded, and the quantum of restraint (the greater the restraint, the stronger the social policy justification must be to uphold it).<sup>416</sup>

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409, § 405.

413. See, e.g., *supra* text accompanying notes 41-43.

414. Bozung, *A Positive Response*, *supra* note 143, at 840-42. The statutory requirement rationale applied because the resale restrictions, as part of the inclusionary housing program, were effectuated through a local legislative act in compliance with the state required housing element law. The preemptive right exception also applied because the Orange County program granted the County an option to purchase, which the County could exercise by either purchasing an inclusionary unit outright, or by offering it to an eligible purchaser. The HCD opinion stressed that in addition to the foregoing reasons for upholding the resale restrictions, the restrictions were reasonable because (a) they were enacted to increase the stock of affordable housing, and (b) an owner was allowed to recoup, at a minimum, any initial investment plus some costs and appreciation as measured by specified guidelines. *Id.* Furthermore, there would generally be a large market of qualified purchasers and if the unit did not sell within a stated period under the resale restrictions, it could be sold on the open market for fair market value. *Id.*

415. See *supra* text accompanying notes 42-43.

416. See *Laguna Royale Owners Ass'n v. Darger*, 174 Cal. Rptr. 136, 144 (Ct. Ap.

Under the Proposed MIHO and most inclusionary housing programs, the social policy furthered by resale restrictions is the provision and retention of housing affordable to low- and moderate-income households. Courts have held that this is a justifiable social policy within the ambit of the state police power.<sup>417</sup> A California court which addressed the validity of resale restrictions in dicta, stated that the restrictions were valid because not all restraints on alienation are void, only those that are unreasonable.<sup>418</sup> The restrictions in that case were reasonable because they were directly related to the provision of affordable housing, which in turn supported, rather than offended, recognized state policies.<sup>419</sup> This strengthens the validity of resale restrictions in inclusionary housing programs because they also are designed to preserve the stock of affordable housing.

In determining reasonableness, a court would also factor in the duration of resale controls. As drafted, the Proposed MIHO's resale restrictions limit the restrictions' duration to a five year period following the initial purchase. Even during that period, they allow a seller a fair investment return, pursuant to detailed provisions.<sup>420</sup>

Most resale controls also set forth a time period within which an inclusionary unit owner may sell a unit only to a particular class of buyers, at a given price.<sup>421</sup> Normally if a qualified buyer is not located within the prescribed time period, an owner can sell to anyone, but at the fixed price.<sup>422</sup> The new owner would then be subject to the same resale restrictions, thereby preserving an affordable unit. The restrictions are therefore reasonably related to the public policy goal of preserving affordable housing.

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1981) ("The day has long since passed when the rule in California was that all restraints on alienation were unlawful under the statute; it is now the settled law in this jurisdiction that only unreasonable restraints on alienation are invalid.").

417. See *City of Oceanside v. McKenna*, 264 Cal. Rptr. 275, 279-80 (Ct. App. 1989).

418. *Martin v. Villa Roma, Inc.*, 182 Cal. Rptr. 382, 383 (Ct. App. 1982). The defendant in this case was a housing cooperative which provided "moderate, low-cost" housing. *Id.* at 382. An issue before the court was whether the defendant corporation's bylaws restricting both the class of buyers and the sales price of a membership in the corporation were invalid as an unreasonable restraint on alienation. *Id.* at 383.

419. *Id.* at 383-84.

420. While the price is not fixed per se, a resale price formula is set forth in California's proposed amendment, thereby limiting the initial sales price and subsequent resale prices. See Proposed MIHO, *supra* note 14.

421. See, e.g., *supra* notes 86-91.

422. Note, however, that this rarely occurs because of the high demand for affordable housing. See *supra* text accompanying notes 79-81, which discusses the lottery process that is typically necessary to choose beneficiaries of inclusionary housing programs.

A court would also look at the alienation precluded and the quantum of restraint. In an inclusionary housing context, both the sales price and class of purchasers are generally restricted. However, inclusionary unit owners are not prohibited from selling their units. In fact, they can generally sell their units at any time, albeit to a restricted class of buyers and at a fixed price. However, as noted previously, most programs limit the period during which an owner must sell to a restricted class member. If the owner cannot find a buyer during that time period, either a specified agency will purchase the unit or the owner can sell it to any willing buyer, at the fixed price. Some programs even allow an inclusionary unit to be sold at market price.<sup>423</sup>

A court would probably uphold the Proposed MIHO resale restrictions, which are typical of resale restrictions found in many inclusionary housing programs, for many reasons. First, the recognized preemptive right exception would apply to options or first rights to purchase. Second, the statutory requirement rule would apply to the Proposed MIHO and to local inclusionary housing programs, because they are representative of the state policy encouraging the production of affordable housing. Third, most restrictions would be deemed reasonable considering the purpose and effect of resale controls. Fourth, resale controls, even those in effect in perpetuity, have been upheld to date. Fifth, state policy favors the production of affordable housing, as manifested through both judicial decisions and legislation.<sup>424</sup>

## 2. Antitrust Law

The Sherman Act (the "Act") prohibits every contract in restraint of trade or commerce, including price-fixing agreements.<sup>425</sup> Resale restrictions could therefore be challenged as violating federal antitrust laws. The Act represents very broad legislation, intended to deal comprehensively with free trade.<sup>426</sup> Courts have thus been left to shape the Act.<sup>427</sup> Early in the history of antitrust law, the Supreme

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423. In this case, an equity or subsidy recapture should kick in to prevent a windfall to the seller and to preserve money for affordable housing programs generally. For a discussion of recapture programs, see *supra* text accompanying notes 93-95.

424. See, e.g., CAL. GOV'T CODE §§ 65583(a)-(c), 65589.5, 65915 (West 1994); *City of Oceanside v. McKenna*, 264 Cal. Rptr. 275 (Ct. App. 1989); *Winkleman v. City of Tiburon*, 108 Cal. Rptr. 415 (Ct. App. 1973).

425. 15 U.S.C. §§ 1-11 (1988).

426. *Standard Oil v. United States*, 221 U.S. 1, 59-60 (1911).

427. *Id.* at 63-64.

Court established the rule of reason, which applies generally to anti-trust cases.<sup>428</sup> The premise of the rule of reason is that the Act can be interpreted neither literally nor in a vacuum. The court stated:

The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.<sup>429</sup>

Consequently, we have another issue which cannot be resolved through a bright-line test separating legal from illegal acts. Instead, a court must make a case by case determination as to whether a contract is in restraint of trade. While the rule of reason is generally utilized in antitrust cases, the Court has established that certain types of activities are so clearly in violation of the Act, that if proof of those activities is presented, a court does not have to resort to the rule of reason. "Among the practices which the courts have heretofore deemed to be unlawful in and of themselves are *price fixing . . . division of markets . . . group boycotts . . . and tying arrangements.*"<sup>430</sup>

In *United States v. Socony-Vacuum Oil Co.*,<sup>431</sup> the Court dealt specifically with price-fixing and held that "[u]nder the Sherman Act a combination formed for the purpose and with the effect of raising, depressing, fixing, pegging, or stabilizing the price of a commodity in interstate or foreign commerce is illegal *per se.*"<sup>432</sup> The *Socony* case focused on combinations as perpetrators of price-fixing schemes because the defendants in that case comprised a combination. But, it is not essential that the price-fixing entity be a combination; it can be a private party or even a city or municipal agency which is responsible

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428. *Id.*

429. *Id.*

430. *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1957) (emphasis added) (citations omitted).

431. 310 U.S. 150 (1940).

432. *Id.* at 223.

for resale administration.<sup>433</sup> While activities and practices of private developers are clearly subject to the Act, it has not always been clear whether governmental activities are also subject to the Act.

In *Lafayette*, the Court confirmed that local governmental activities are within the scope of federal antitrust laws.<sup>434</sup> However, the *Lafayette* Court reiterated that certain types of governmental activities are exempt from antitrust laws. In discussing what types of activities are within the purview of antitrust laws and which are not, the Court stated that “[w]e . . . conclude that the *Parker doctrine* exempts only anticompetitive conduct engaged in as an act of government by the State as sovereign, or, by its subdivisions, pursuant to state policy to displace competition with regulation or monopoly public service.”<sup>435</sup>

In determining whether local government action is subject to the Act, a crucial question is whether “the state policy requiring the anticompetitive restraint as part of a comprehensive regulatory system, was one clearly articulated and affirmatively expressed as state policy.”<sup>436</sup> Therefore, if the Proposed MIHO were at issue, since it “clearly articulates and affirmatively expresses” California state policy,<sup>437</sup> any provisions restraining trade, including price-fixing provisions, would be exempt from the Act.

When analyzing a local inclusionary housing program’s resale controls, including price-fixing provisions, the link between state policy and price-fixing agreements is more tenuous. “[I]n the absence of evidence that the State authorized or directed a given municipality to act as it did, the actions of a particular city hardly can be found to be pursuant to ‘the state[’s] command,’ or to be restraints that ‘the state . . . as sovereign’ imposed.”<sup>438</sup> Nonetheless, a local government may still be able to shelter price-fixing agreements under the *Parker*

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433. *City of Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1978).

434. *Id.* at 393-94. Note, however, that the *Lafayette* Court was divided (an understatement). Justice Brennan was joined by four Justices (including the Chief Justice) in part I of the opinion, and he was joined by three Justices in parts II and III of the opinion. Justice Marshall filed a concurring opinion and Chief Justice Burger filed an opinion concurring in part and concurring in the judgment. Justice Stewart filed a dissenting opinion joined by two Justices for the entire dissent and by a third Justice for all but part II-B of the dissent. And finally, Justice Blackmun filed a dissenting opinion.

435. *Id.* at 413. The *Parker doctrine* provides that in determining whether the action of a municipality is exempt from antitrust laws, the critical factor is “whether the challenged action was ‘an act of government’ by the State as ‘sovereign.’” *Id.* at 409.

436. *Id.* at 410.

437. The state policy of providing housing for all segments of the population has been established earlier in this Article. See, e.g., *supra* notes 41-43 and accompanying text.

438. *Lafayette*, 435 U.S. at 414 (citations omitted).

doctrine, even without an express state directive. The *Lafayette* Court stated:

While a subordinate governmental unit's claim to *Parker* immunity is not as readily established as the same claim by a state government sued as such, we agree . . . that an adequate state mandate for anticompetitive activities of cities and other subordinate governmental units exists when it is found "from the authority given a governmental entity to operate in a particular area, that the legislature contemplated the kind of action complained of."<sup>439</sup>

A locality could argue that resale controls are instituted for the purpose of providing and retaining affordable housing, which furthers the state's public policies of assisting "in the development of adequate housing to meet the needs of low- and moderate-income households . . . ,"<sup>440</sup> and conserving and improving "the condition of the existing affordable housing stock. . . ."<sup>441</sup> Furthermore, the legislature has stated that "[t]he provision of housing affordable to low- and moderate-income households requires the cooperation of *all* levels of government."<sup>442</sup> Thus, in reading various state statutes together, they mandate that all state and local government agencies cooperate in effectuating the state policies of providing housing for all segments of the population, and developing, conserving, and improving the stock of housing for low- and moderate-income families. So long as the state, and its agencies by extension, are engaged in activities which further state policy, even if such policies include price-fixing agreements, they should be upheld under the *Parker* doctrine.

A tougher issue is whether price-fixing agreements between a developer, sellers, and buyers, all of whom are private parties, could be upheld.<sup>443</sup> While an inclusionary housing proponent would argue that the private parties were merely acting pursuant to a locality's legislation, and thus pursuant to state approved and locally mandated laws, there is a rather large gap between a "clearly articulated and affirmatively expressed state policy" and a private contract fixing prices. Some commentators have indicated that private price-fixing

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439. *Id.* at 415 (citations omitted).

440. CAL. GOV'T CODE § 65583(c)(2) (West 1994).

441. CAL. GOV'T CODE § 65583(c)(4) (West 1994).

442. CAL. GOV'T CODE § 65580(c) (West 1994) (emphasis added).

443. In fact, many resale restrictions are privately recorded by developers through covenants or deed restrictions. *See supra* text accompanying notes 84-85. While developers perpetrate restrictions, they are in many cases simply complying with laws enacted by governments requiring them to establish mechanisms for preserving affordability.

agreements in the affordable housing context would probably not be upheld, in spite of the policies served by such agreements.<sup>444</sup> However, I have found no antitrust challenges to price-fixing components of inclusionary housing programs. That, coupled with the strong policy favoring the provision and retention of affordable housing, indicates that resale price maintenance agreements may well be upheld, in spite of expressed misgivings.

## VI. CONCLUSION

There are many policies which support and oppose inclusionary housing. The ultimate determination of whether it is acceptable turns in part on particular objectives. For example, if one objective is to provide and retain affordable housing, then inclusionary housing is clearly acceptable. If another objective is to promote integrated housing, it is again acceptable. If an objective is to reduce land controls and promote a free market, then it is not acceptable. This is where compromise becomes significant. If one accepts the ideas that there will be land controls, land is becoming scarcer, there is an affordable housing crisis, and government cannot solve that crisis by itself, then inclusionary housing becomes more palatable. The difficulty is in designing a program which balances inclusionary housing's benefits and burdens. A program must take into account the need to produce and retain affordable housing while providing incentives which will offset costs incurred by parties as a result of inclusionary housing. A program's administration and public education are also important to its success and acceptability. Even if there are some remaining problems resulting from inclusionary housing, they do not come close to equaling the benefits which it provides—shelter for families who might not otherwise have roofs over their heads. Thus, it is an acceptable way to ameliorate the affordable housing crisis.

While inclusionary housing programs could be challenged on a number of legal grounds, it is unlikely that any of those challenges

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444. Betsy Strauss & Daphne Stegman, *Moderate-Cost Housing After Lafayette: A Proposal*, 11 URB. LAW. 209 (1979).

As in resale price maintenance cases, the effect of the contracts would be to destroy the free market that normally operates to set prices based upon the independent decisions of willing sellers and buyers. All purchasers would be bound by contract to observe fixed resale prices. Even though the restriction on resale prices is known to the purchasers, the Sherman Act still prohibits the builder from fixing prices for future sales.

*Id.* at 219-20.



would succeed. Most programs, including the Proposed MIHO, would survive legal challenges because they are reasonably related to the valid governmental purpose of providing affordable housing. To ensure their success, they should be designed to treat similarly situated parties equally, include sufficient incentives so that developers can earn a reasonable profit, and prevent impacted parties from suffering a total economic loss.

In sum, inclusionary housing programs are acceptable and would likely withstand legal challenges. Thus, they should be supported, with the caveat that they should be designed to balance the public and private interests in order to equitably share any of its burdens and benefits.