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Do Post-*Palmer* and *Patterson* Residential Nexus Studies Satisfy Applicable Constitutional and Statutory Requirements?

Prepared for
Building Industry Association of the Bay Area
by
Geoffrey L. Robinson
and Christopher A. Chou

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I. INTRODUCTION

This legal analysis addresses whether the new generation of nexus studies prepared by consulting firms following recent judicial decisions (*Palmer*, *Patterson*, *Sterling Park*, and the California Supreme Court's grant of review in *CBIA v. City of San José*) satisfy the governing standard for exactions described by the California Supreme Court in *San Remo Hotel v. City and County of San Francisco*, 27 Cal. 4th 643 (2002).[1] That decision holds that legislatively imposed development fees and exactions "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development." *Id.* at 663–64. To satisfy the constitutional and legislative standards embodied in the reasonable-relationship test, the local agency must produce evidence showing that "(1) there is a cause-and-effect relationship between the owner's desired use of the property and the social evil that the fee seeks to remedy, and (2) the fee is reasonably related in both intended use and amount to that social evil." 27 Cal. 4th at 687 (Baxter, J. concurring and dissenting). In other words, an ordinance establishing a legislatively imposed development exaction can only be sustained if both its purpose and extent are reasonably related to some negative public impact proximately caused by the projects on which the exaction would be imposed.

This analysis focuses on the methodology underlying nexus studies commissioned specifically to justify affordable housing impact fees on new residential development. The fees purportedly justified by the methodology are staggering. A study prepared for Hayward purports to justify a fee of $81,900 per market rate unit for single-family detached units ($40.98/sq. ft.) and $82,800 ($44.73/sq. ft.) per market rate unit for townhomes/condominiums. A study prepared for Fremont purports to justify a fee of $66,000 per market rate unit for single-family detached ("large lot") units; $52,000 per market rate unit for single-family detached ("small lot") units; $41,100 per market rate unit for townhome units; $39,600 per market rate unit for condominium units; and $27,800 per market rate unit for apartment units. Taking the Fremont figures,

[1] The nexus analyses that are the subject of this memorandum are those generally described in Cray, A., *The Use of Residential Nexus Analysis in Support of California's Inclusionary Housing Ordinances: A Critical Evaluation: A report to the California Homebuilding foundation* (Nov. 2011) (available at http://www.cbia.org/go/linkservid/06D3172D-35C3-4C71-9A9098D439C63874/showMeta/0/).

applying the "justified" fees to a 100-unit townhome project would impose $4.1 million in affordable housing impact fees on the project.

Recently, this methodology has also begun to be used to justify other inclusionary housing mandates, such as the "traditional" inclusionary zoning requirement that the developer sell a certain percentage of units at below-market rates or pay an in-lieu fee to fund affordable housing. In *Sterling Park, L.P. v. City of Palo Alto*, 57 Cal. 4th 1193 (2013), the California Supreme Court held that such requirements constitute "exactions" under the Mitigation Fee Act. The Court is currently considering, in *California Building Industry Association v. City of San José*, No. S212072 (Cal. Supr. Ct.), whether inclusionary housing ordinances that exact property interests or in-lieu fees must be reasonably related to the impact of development, as set forth in the *San Remo* decision. Assuming the Court adheres to its conclusion in *Sterling Park* that such inclusionary requirements constitute exactions subject to the Mitigation Fee Act, it appears highly probable that the Court will hold that these requirements must satisfy the reasonable-relationship standard described in *San Remo*. If so, the legal analysis in this memorandum will apply to nexus studies commissioned in support of the full range of inclusionary housing provisions that require the transfer of money or an interest in property from the developer, including "traditional" inclusionary zoning mandates.

II. SUMMARY OF ANALYSIS AND CONCLUSIONS

A. Residential Nexus Studies.

In an attempt to satisfy the governing constitutional and statutory requirements for development exactions, municipalities have commissioned "residential nexus studies" that seek to demonstrate the legally required nexus between new market rate housing and the need for affordable housing. A description of the methodology employed in these studies appears in a recent Keyser Marston report[2] for the City of San José:

> At its most simplified level, the underlying nexus concept is that the newly constructed units represent net new households in San José. These households represent new income in San José that will consume goods and services, either through purchases of goods and services or "consumption" of governmental services. New consumption translates to jobs; a portion of the jobs are at lower compensation levels; low compensation jobs relate to lower income households that cannot afford market rate units in San José and therefore need affordable housing.

This methodology for new rental housing is summarized in the chart that follows:

[2] Keyser Marston Associates, Inc. Residential Nexus Analysis – City of San José (June 2014) at 8 (available at http://www.sanJoséca.gov/DocumentCenter/View/32877) ("KMA--San José).

1) Construction of New Market Rate Units

2) New Household Moves into the New Market Rate Unit

- All new households assumed to represent new income and new spending in San José

3) Determine Value of Market Rate Units

- Two apartment prototypes chosen for use in the analysis
- Prototypes are based on an intended average or typical apartment prototype in San José

4) Estimate Income of Renter Households

- Assumes household spends 30% of income on rent
- Uses Census data for Santa Clara County and makes adjustments to meet consistency with CA Health & Safety code standard
- Resulting assumption is household income is 3.3x rent
- Annual household income calculated for apartment renters ranges from $94,000 - $107,000

5) Estimate Income Available for Expenditures

- To adjust gross household income, assumptions are made about household:
  -Federal and state income taxes
  -Contributions to social security and Medicare
  -Savings rates
  -Debt obligations
  -Spending patterns
- Assumes 65% - 66% of gross income is available for expenditures (before rental/housing payments)

6) Use IMPLAN Model to Estimate Job Creation

- Input household expenditures into IMPLAN model
- Jobs calculations are produced, including all jobs, full-time and part-time

7) Use IMPLAN Results to Calculate Jobs by Industry Category

- Calculations are based on IMPLAN output
- Calculates and estimates amount of household expenditures spent locally
- Preparer inputs assumptions about location of jobs

8) Use of KMA Jobs Housing Model

- Estimates employment growth for industries related to consumer spending estimates
- Changing industries adjustment and net new jobs:
- Adjustment from employees to employee households:
- OES to generate an estimate of employment by occupational category

9) Estimate Employee Households Meeting Lower-Income Definitions

- Occupations translated to employee incomes based on County wage and salary info from EDD
- For each occupational category, OES data provides distribution of specific occupations
- Model uses distribution of wages to calculate % of worker households in each income category
- For households with more than one worker, individual employee income data used to calculate household income by assuming multiple earner households have individuals with similar incomes
- The step above is repeated around 400 times in the nexus analysis for each of the over 100 occupations and at each of the four affordable income tiers
- A matrix is established to estimate the percentage of household income that would qualify in the affordable income tiers

10) Estimate Distribution of Household Size and Number of Workers

- County demographics examined to develop probability factor for each combination of household size and number of workers
- Five sets of probability factors are used to reflect differences in household patterns by income and are derived from 2006-2010
- Applies separate sets of probability factors for five separate compensation ranges

11) Estimate Number of Households that Meet Size and Income Criteria

- Combine matrix of results that estimate employee households with the probability of a worker household
- Calculates the percentage of households that fall into an affordability tier
- The percentages are multiplied by number of households to calculate the number of households in each affordability tier
- Methodology is repeated for each of the four income tiers

12) Estimate Affordability Gap

- Estimate difference between cost of developing a residential apartment unit and the amount a household can afford to pay
- For rental units, affordability gap calculated after funding available through 4% tax credits and tax exempt bonds
- Development Costs:
- Affordability Gap:
- Net operating income calculations are estimated and used to determine the amount of tax exempt bond debt supportable to finance the construction of units

13) Calculate Cost per Market Rate Unit

- Calculate the product of the estimated low income households and the estimated affordability gap, per the respective income category

As indicated, the methodology begins with "prototypical market rate units," assumes a rental rate for those units, estimates the gross household income of the people renting the units, estimates the net household income available for expenditures, assumes a rate of expenditure on local goods and services, estimates the number of local jobs created by those expenditures, translates these jobs into new households, estimates the size and occupational and income distribution of the households, estimates the number of these households that fall within inclusionary housing parameters, calculates the total development cost of new market rate units that would

accommodate those households, deducts the financing available from tax credits and tax-exempt debt for those units, and thereby purports to calculate the "affordability gap" for each of the tiers of lower-income households "generated" by new market-rate units. The "affordability gap" is then translated into the "total nexus cost" for each new market-rate unit. This multi-step causation analysis is, in turn, dependent upon a host of assumptions about matters such as household income of occupants of market-rate rental units, tax, personal savings and debt rates, local (versus regional or online) spending patterns, number, type and location of net new jobs created, number of persons from outside the community occupying those jobs, size, number and total income of new households "created" by those jobs, and other variables.

B. Governing Law.

Affordable housing fees, like other development impact exactions, "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development." *San Remo Hotel v. City and County of San Francisco,* 27 Cal.4th 643, 663–664 (2002). Under the Mitigation Fee Act, Govt. Code, §§ 66000–66025, the local agency must demonstrate a "reasonable relationship" between the need for and use of the exaction and the type of development project on which the exaction is imposed. Govt. Code § 66001(a)(3). The local agency has the burden of producing evidence in support of these determinations. *Homebuilders Ass'n of Tulare/Kings Counties, Inc. v. City of Lemoore,* 185 Cal.App.4th 554, 561 (2010). The agency must also show that a valid method was used for establishing a reasonable relationship between the fee charged and the burden posed by the development. *Shapell Industries, Inc. v. Governing Board,* 1 Cal.App.4th 218, 235 (1998).

The Mitigation Fee Act embodies both constitutional and statutory standards. *Ehrlich v. City of Culver City*, 12 Cal. 4th 854, 866–67 (1996) (Term "reasonable relationship" as used in Mitigation Fee Act "embraces both constitutional and statutory meanings" and should be construed in light of both federal and state constitutional jurisprudence); *accord*, *San Remo Hotel v. City and County of San Francisco*, 27 Cal. 4th 643, 663–664 (2002) ("As a matter of both statutory and constitutional law, [exactions] must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development."). This standard reflects fundamental fairness principles under takings law, which prevent the 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." *United States v. Armstrong*, 364 U.S. 40, 49 (1960); *accord, Palazzolo v. Rhode Island*, 533 U.S. 606, 617–618 (2001); *Lockaway Storage v. County of Alameda*, 216 Cal. App. 4th 161, 183 (2013) ("The takings clause precludes the 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."). California courts have explicitly recognized that this fairness principle is central to takings law both in the context of regulatory takings and in the realm of inverse condemnation resulting from other governmental acts or omissions that damage or destroy property. *See, e.g., Holtz v. Superior Court*, 3 Cal. 3d 296, 303–304 (1970); *Liberty v. California Coastal Commission*, 113 Cal. App. 3d 491, 504 (1980).

In *Shapell*, 1 Cal. App. 4th at 2357, the court explained that "[w]hile it is 'only fair' that the public at large should not be obliged to pay for the increased burden on public facilities caused by new development, the converse is equally reasonable: the developer must not be required to shoulder the entire burden of financing public facilities for all future users." Under this principle, "[i]t follows that [impact] fees are justified only to the extent that they are limited to the cost of increased services made necessary by virtue of the development." *Id*. at 236. The local agency must therefore show that "a *valid method* was used for arriving at the fee in question, 'one which established a reasonable relationship between the fee charged and the burden posed by the development.'" *Id.*, quoting *Bixel Associates v. City of Los Angeles*, 216 Cal.App.3d 1208, 1219 (1989) (emphasis added).

The mandate that the fee be "reasonably related," according to its plain meaning, requires a reasonable causal connection or link between the development and the impact sought to be addressed. *San Remo Hotel v. City and County of San Francisco*, 27 Cal. 4th 643, 687 (2002) ("[F]ee does not violate the Takings Clause so long as (1) there is a cause-and-effect relationship between the owner's desired use of the property and the social evil that the fee seeks to remedy, and (2) the fee is reasonably related in both intended use and amount to that social evil." 27 Cal. 4th at 687 (Baxter, J. concurring and dissenting); *Homebuilders Ass'n of Tulare/Kings Counties, Inc. v. City of Lemoore*, 185 Cal.App.4th 554, 576 (2010) (Ardaiz, J. concurring) (close connection required).

If no reasonable causal connection exists between new residential development and affordable housing needs, the agency cannot sustain the burden under the Mitigation Fee Act of establishing that there is a reasonable relationship between (1) the development and the *need* for affordable housing; (2) the development and the *use* of the exaction to provide affordable housing; or (3) the amount or extent of the exaction and the *cost* of the affordable housing attributable to the development. Govt. Code §§ 66001(a)(3)–(4);(b). Without that relationship, the affordable housing fee also constitutes an unconstitutional condition because the government is effectively requiring the applicant to give up constitutional rights under the Takings Clause[3] in order to obtain the required permits. *Koontz v. St. Johns River Water Management District*, 133 S. Ct. 2586, 2596 (2013) (Demands for money or property in the land-use permitting context lacking the required nexus with the presumed impact "run afoul of the Takings Clause not because they take property but because they impermissibly burden the right not to have property taken without just compensation.")

Proximate cause analysis -- which is routinely used by courts in a variety of contexts including cases arising under the Takings Clause -- is appropriate to the determination whether the causal component of the reasonable-relationship standard is satisfied. *See Penn. Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978) ("[W]hether a particular restriction will be rendered invalid by the government's failure to pay for any losses proximately caused by it depends

[3] Unless otherwise indicated, references to the "takings clause" are to the corresponding clauses of the federal and state constitutions, which the California Supreme Court has interpreted congruently in the context of regulatory takings. *See San Remo Hotel*, 27 Cal. 4th at 667.

largely upon the particular circumstances in that case."); *Belair v. Riverside County Flood Control Dist*., 47 Cal. 3d 559 (1988). Such analysis asks both whether a sufficient causal connection exists in fact and whether fairness and justice warrant requiring the property owner, rather than society as a whole, to address the social impact through mitigation. Proximate causation reflects both "'ideas of what justice demands'" and "'of what is administratively possible and convenient,'" *Anza Steel v. Ideal Steel Supply Corp.*, 547 U.S. 451 (2006). California courts have highlighted the close connection between the proximate cause requirement and the constitutional fairness doctrine (referred to in the inverse condemnation context as the "loss distribution premise"). *See Holtz v. Superior Court*, 3 Cal. 3d 296, 303–304 (1970). The proximate cause inquiry works to answer the same question as the reasonable-relationship test—whether the development is sufficiently connected with the targeted social problem to make it fair and reasonable to require the property owner to address it through mitigation.

Some municipalities, however, have taken the position that the unconstitutional conditions doctrine in this context does *not* require establishing a meaningful causal relationship. For example, when the City of San José adopted a fee on new rental housing based on the KMA study cited in footnote 2, *ante*, the Mayor of San José circulated a memorandum to his colleagues admonishing that: "[t]he nexus study provided by our consultant does not prove that building market rate rental housing causes an increase in the need for affordable housing. The nexus study is based on the assumption that proving causation is not necessary. This novel interpretation of the law would leave few limits on the things that could be funded with impact fees." *Memorandum from Mayor Chuck Reed to City Council*. (Nov. 17, 2014).[4] In response, the City Attorney opined orally at the public hearing that no such causal relationship was necessary, citing as authority the Ninth Circuit's 1991 opinion in *Commercial Builders of Northern California v. City of Sacramento*, 941 F.2d 872 (1991).

Commercial Builders does not support imposing affordable housing impact fees on residential development. The 2-1 decision upheld Sacramento's affordable housing impact fee imposed on commercial development. In enacting the fee, Sacramento relied on a nexus study prepared by Keyser Marston Associates using an economic chain-of-events theory similar to the methodology in the studies discussed here. The *Commercial Builders* majority applied mere "rational basis" review to uphold the fee, holding that its judicial inquiry was appropriately limited to determining whether the fee was reasonably related to the "legitimate *purpose* it seeks to achieve," that purpose being the city's interest in the provision of affordable housing generally. *Commercial Builders* at 873 (emphasis added). *See also, The Adamson Companies v. City of Malibu*, 854 F.Supp. 1476, 1502 (1994) ("*Commercial Builders* held that the 'substantially advance' test does not require scrutiny any stricter than 'rationally related' when it wrote 'substantially advance….'"). But as a federal district court observed in 2008, "[m]uch has changed in takings law since *Commercial Builders* was issued." *Kamaole Point Development LP v. County of Maui*, 573 F.Supp.1354, 1366 (2008). Among the changes have been the U.S. Supreme Court's decisions in *Dolan*, *Lingle*, and *Koontz*, and the California Supreme Court's

[4]http://sanjoseca.gov/DocumentCenter/View/37550.

decisions in *San Remo* and *Sterling Park*. the two latter expressly rejecting the view that an exaction can be sustained based on the mere existence of a rational (or reasonable) relationship between the exaction and government's interest in providing affordable housing—no matter how substantial or pressing that interest is. As discussed above, *San Remo* and *Sterling Park* hold that legislatively-imposed exactions are not subject to such "rational basis review," as the *Commercial Builders* majority held, but instead can only be upheld if there is a substantial causal connection between the exaction and a deleterious public impact caused by the development. The statement of the law contained in the dissenting opinion in *Commercial Builders* has been proven correct:

> Historically, courts have upheld exactions when states were able to justify them as serving a public purpose related to the burdens caused by development. For example, courts have sustained requirements that developers construct various on-site improvements, such as sewers, watermains, sidewalks, curbs and gutters, storm drains, and landscaping. Requiring off-site improvements that serve a public purpose, such as roads, schools, parks and sewage treatment plants, may also be justified where the requirement alleviates a public burden or ameliorates harmful effects caused by the development…. Sacramento would have developers pay not just for public improvements necessitated by development, but for private subsidies with little or no causal connection to development…. Sacramento has commissioned a study that demonstrates at most a tenuous and theoretical connection between commercial development and housing needs. But the Takings Clause requires a cause-and-effect relationship between the two…. The new workers attracted by the new jobs associated with the new development surely will increase the demand for all manner of goods and services. If Sacramento has shown a sufficient causal connection in this case, we can be expected next to uphold exactions imposed on developers to subsidize small business retailers, child-care programs, food services, and health-care delivery systems." *Commercial Builders* at 876-877 (Beezer, J., dissenting)

C. Application.

An expert study or report can be a valuable aid in establishing the required causal link (in nature and extent) between new development and societal impacts (as exemplified by engineering studies routinely employed to establish appropriate mitigation for impacts on traffic, storm drainage and wastewater, or by analyses matching student enrollment with new homes to establish actual student generation rates and calculate school impact fees). However, in order for such expert opinion or analysis to be validly relied upon, it must have some grounding in the facts and must reflect accepted principles and methods. The reasonable-relationship determination required by law cannot be satisfied simply by an expert's assurance -- without any empirical support or generally accepted methodology -- that the required factual connection exists. Courts have long held that an expert's opinion "is no better than the facts on which it is based." *Kennemur v. State of California,* 133 Cal. App. 3d 907, 923 (1982). "Where an expert bases his conclusion upon assumptions . . . which are not reasonably relied upon by other experts,

or upon factors which are speculative, remote or conjectural, then his conclusion has no evidentiary value . . . ." *Pacific Gas & Electric Co. v. Zuckerman*, 189 Cal.App.3d 1113, 1135 (1987); *City of San Diego v. Sobke*, 65 Cal.App.4th 379, 396 (1998).

As with a court, an agency can and should disregard expert opinion that lacks an adequate factual foundation and is not based upon a generally accepted methodology. For example, "an expert's opinion which says nothing more than 'it is reasonable to assume' that something 'potentially ... may occur'" but has no basis in fact does not constitute substantial evidence that can reasonably be relied on by a public agency. *See Apartment Association of Greater Los Angeles v. City of Los Angeles*, 90 Cal.App.4th 1162, 1173-1176 (2001). *See also Lucas Valley Homeowners Ass'n v County of Marin*, 233 Cal. App. 3d 130 (1991) (Expert testimony by real estate agent regarding potential decline in property values was not substantial evidence because it was an imprecise opinion without supporting verifiable data such as comparables); *Citizens Comm. to Save Our Village v City of Claremont*, 37 Cal. App. 4th 1157, 1170 (1995) (no factual foundation for architect's letter claiming a historically significant landscape plan had been implemented on project site); *Gentry v City of Murrieta*, 36 Cal. App. 4th 1359, 1422 (1995) (letter from engineering professor about groundwater and erosion impacts was not substantial evidence because it was not based on an adequate factual foundation).

Residential nexus studies, with their lengthy series of untested assumptions, neither establish the required causal connection between new development and affordable housing needs nor show why it is fair and reasonable to require development applicants – rather than the general public – to shoulder the burden of providing affordable housing. They do not establish that new residential development "causes" or even contributes to the need for affordable housing. The lack of affordable housing has been a problem in California for decades. Scores of government and academic studies, supported by a wealth of research and economic data, have demonstrated that the need for affordable housing has been created over an extended period by a complex amalgam of factors, including restrictive zoning and growth controls, impact fees, complex environmental regulations, outdated building codes, multifamily housing restrictions, and NIMBYism. None of these studies has either postulated or demonstrated any causal relationship between new residential development and affordable housing needs.

The residential nexus studies, on the other hand, are not based on any research or empirical evidence supporting the existence or extent of a cause-and-effect relationship between new market-rate housing and the need for affordable housing. These studies do not assess, rely on, attempt to controvert or even mention the substantial body of governmental and academic literature and supporting data identifying the root causes of affordable housing needs. Nor are they, themselves, based upon any body of established academic, scientific or technical literature. A comprehensive review of potentially relevant sources in 2011 (including journal articles, books, presentations and government reports) failed to disclose any literature -- peer-reviewed or otherwise -- supporting the methodology used in the residential nexus analyses.[5] Thus, in

[5] Cray, A., *The Use of Residential Nexus Analysis in Support of California's Inclusionary Housing Ordinances: A Critical Evaluation: A report to the California Homebuilding foundation*

addition to lacking any empirical justification and failing to controvert the large body of academic, technical and governmental literature identifying other causes of affordable housing needs, the residential nexus studies employ a methodology that has not been generally accepted, or even considered, by the academic, scientific or technical community. They rely entirely on a combination of assumptions and modeling to construct a theory under which a market-rate home generates economic forces that create a "need" for a below-market-rate home. But these studies fail to demonstrate that the new housing has any *causative*, as opposed to correlative, relationship with the need for affordable housing.

City of San José and Keyser Marston written responses to questions posed by BIA of the Bay Area indicate that the methodology underpinning these residential nexus studies: (1) has not been validated or endorsed in any academic or professional journals; (2) was developed specifically for the purpose of supporting affordable housing impact fees on new residential development; (3) has not been used in an exaction context other than affordable housing; (4) cannot adequately distinguish between purported housing needs generated by residential development and overlapping housing needs projected by the same methodology when applied to nonresidential development; and (5) has never been empirically validated (only that it purportedly "aligns with accepted economic principles that households demand goods and services and that the businesses and institutions that provide those goods and services need employees.") Keyser Marston was also unable to provide the methodology's cumulative margin of error for the final results.

In response to the question—"Is it your professional opinion that the Study establishes a causal relationship between building market rate housing and a quantifiable need for affordable housing or rather a correlative one?"—Keyser Marston refused to provide such an opinion and instead ventured a legal conclusion: "The City's Consultant prepared the nexus analysis to meet the reasonable relationship standard under the Mitigation Fee Act, and in the Consultant's opinion, the analysis meets that standard."

Moreover, even assuming these studies showed *some* theoretical connection between residential development and affordable housing needs, this falls far short of the *substantial* cause-and-effect relationship required under the reasonable-relationship standard and proximate cause principles. Causal chains far less tenuous have been rejected under proximate cause analysis simply because there are too many dependent assumptions and variables. The multitude of steps in the analysis, any one of which can be heavily skewed in one direction or another by independent factors, render the ultimate conclusion little more than speculation, which is antithetical to the "substantial cause-and-effect" relationship required by law.

The causation theory underlying the residential nexus analyses also fails the normative/evaluative component of proximate cause since it does not comport with the governing constitutional and statutory principles. The policies of reasonableness, fairness and

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(Nov. 2011) at 7 (available at http://www.cbia.org/go/linkservid/06D3172D-35C3-4C71-9A9098D439C63874/showMeta/0/).

justice embodied in the state and federal constitutions are not satisfied by studies that demonstrate only an attenuated and theoretical link between the development and the need.

The lack of affordable housing in California is a longstanding problem that exists for a multitude of reasons unrelated to new residential development. The costs of addressing it should, in fairness, be borne by society as a whole, not allocated to residential developers based on administrative convenience or leverage, or because government officials (and the electorate) have not made funding affordable housing a public policy priority.

III. BACKGROUND

A. Affordable Housing Needs in California.

The lack of affordable housing in California has been a major social and political issue since the 1970s. In 1975, the California legislature found that:

> there exists within the urban and rural areas of the state a serious shortage of decent, safe, and sanitary housing which persons and families of low or moderate income, including the elderly and handicapped, can afford. This situation creates an absolute present and future shortage of supply in relation to demand, as expressed in terms of housing needs and aspirations, and also creates inflation in the cost of housing, by reason of its scarcity, which tends to decrease the relative affordability of the state's housing supply for all its residents.[6]

The problem has steadily grown worse since. Thirteen of the fifteen least affordable metropolitan housing markets in the nation are in California.[7] The severity and intractability of the problem is exemplified by the dozens of legislative enactments designed to streamline the approval process and provide incentives to local agencies to approve affordable housing projects. *See, e.g.*, Housing Element Statutes (Gov't Code §§65580-65589.8 and §§65751-65761); Housing Accountability Act (§§65589.5-65589.6); prohibitions against discrimination against affordable housing (Id., §65008); statute of limitations (§65009); regional transportation plans (Id., § 65080

[6] Gov't Code section 50003(a).

[7] Wells Fargo/NAHB Housing Opportunity Index; 4th Quarter 2013 available at http://www.nahb.org/reference_list.aspx?sectionID=132 Several reports have concluded that the state is now adding approximately three jobs for every housing unit constructed. Fulton, William, "Housing Rises on Sacramento's List of Priorities," California Planning and Development Report (Solimar Research Group 2000) available at http://www.cp-dr.com/node/1373. *Id.*

– 65086.5); "no net loss statute" (Id., §65863); "least cost" zoning law (Id., §§65913-65913.2); density bonus law (Id., §§65915-65918).

The legislature has found that:

> 1. The availability of housing is of vital statewide importance, and the early attainment of decent housing and a suitable living environment for every Californian, including farmworkers, is a priority of the highest order.
>
> 2. The early attainment of this goal requires the cooperative participation of government and the private sector in an effort to expand housing opportunities and accommodate the housing needs of Californians of all economic levels.

And, of particular importance to the questions presented here, the Legislature has also found that:

> California housing has become the most expensive in the nation. The excessive cost of the state's housing supply is partially caused by activities and policies of many local governments that limit the approval of housing, increase the cost of land for housing, *and require that high fees and exactions be paid by producers of housing.* (*Id.*, §65589.5, emphasis added)

Scores of studies and reports have documented that the lack of affordable housing is the result of a complex interaction of factors, including California's chronic undersupply of new housing units generally relative to job and population growth, restrictive zoning and growth controls, excessive impact fees, complex environmental regulations, obsolete building codes, multifamily housing restrictions, and NIMBYism.[8] Indeed, the term "inclusionary zoning" was coined in deliberate contrast to "exclusionary zoning," and some affordable housing advocates have justified inclusionary housing policies as "a means to recapture land prices that have been artificially inflated by communities' exclusionary policies."[9] New residential development is not among the factors cited in any of these studies as creating a need for affordable housing. Even ardent defenders of the legality of these nexus studies, in moments of candor, recognize as much:

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[8] *See* "*Why Not In Our Community?" Removing Barriers to Affordable Housing. An Update to the Report of the Advisory Commission on Regulatory Barriers to Affordable Housing* (HUD 2004) at 5 (available at http://www.huduser.org/portal/Publications/wnioc.pdf)

[9] Kautz, B., *Comment, In Defense of Inclusionary Zoning: Successfully Creating Affordable Housing*, 36 U.S.F. L. REV. 971, 983 (2002).

> Has the need for affordable housing increased in recent years? Yes, it has…. The need has increased recently, particularly in parts of the State such as the San Francisco Bay Area, due to a confluence of several factors. First, the demise of redevelopment and a reduction in federal programs have led to a serious drop in funding available to affordable housing. For example, in Santa Clara County, it has been estimated that total funding available for affordable housing in 2008 (the last 'normal' year) was approximately $126 million. In 2013, the corresponding number was $47 million…. The second factor has been the booming local economy. That has lowered the vacancy rate on rental housing, created a white-hot real estate market for medium- to high-density multi-family housing, but of course, also raised rents.[10]

While no single factor is identified in these studies as the sole or principal cause of affordable housing issues, a unifying theme of these studies is that affordable housing needs are a broad social problem[11] that must be addressed through a comprehensive range of policy responses and measures (including streamlining the development approval process, eliminating restrictive zoning regulations, providing financial incentives, counteracting NIMBYism, reducing the complexity and uncertainty of environmental requirements). The societal dimension of the problem is reflected in the California Legislature's passage of "no less than 19 different sets of laws and programs [in] efforts to both increase the housing available to Californians and to help make it affordable.") *See Wilson v. City of Laguna Beach*, 6 Cal. App. 4th 543, 545 (1992).

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[10] Faber, A., *Inclusionary Housing Requirements: Still Possible?* (September, 2014, presented at the League of California Cities City Attorneys' Department 2014 Annual Conference) at 2-3 (available at http://www.cacities.org/Resources-Documents/Member-Engagement/Professional-Departments/City-Attorneys/Library/2014/2014-Annual/9-2015-Annual-Andrew-Faber-Inclusionary-Housing-Re.aspx)

[11] The explicit nature of the societal contract to meet the housing needs of all members of society is spelled out in various state and federal measures, typical of which is the Housing Act of 1949 (42 USC §§ 1441–1490r), which calls for the "realization as soon as feasible of the goal of a decent home and suitable living environment for every American family."

B. Inclusionary Housing Requirements.

Despite the absence of evidence linking new residential development with the creation of affordable housing needs, over the past 30 years, an increasing number of municipalities have turned to new housing developers to provide affordable housing.[12]

Inclusionary housing requirements (also referred to as affordable housing requirements) generally require builders to sell or rent a specified percentage of new homes at rates deemed affordable to very-low, low, or moderate-income households. The designated units must generally retain their restricted price or rental rate status for a specified period of time, typically fifty-five years or more.[13] These requirements have generally been included in municipality's zoning ordinance and characterized as zoning regulations, not development exactions.

This characterization as "zoning" rather than "exactions" in many cases has reflected a conscious legal strategy devised by affordable housing advocates and municipal attorneys. This strategy recognized the inherent difficulties in demonstrating the statutory and constitutional requirements for exactions, and recommended that municipalities characterize their inclusionary housing requirements as zoning restrictions in order to take advantage of the more lenient, rational basis standard of review for police power enactments.[14]

C. The *Palmer* and *Patterson* Decisions.

The legal landscape concerning inclusionary housing requirements changed significantly in 2009 with the decisions in *Building Industry Association of Central California v. City of Patterson*, 171 Cal. App. 4th 886 (2009) and *Palmer/Sixth Street Properties L.P. v. City of Los Angeles*, 175 Cal. App. 4th 1396 (2009).

In *Patterson*, a homebuilder challenged an increase in an in-lieu fee adopted as part of an inclusionary housing ordinance. Relying on the California Supreme Court decision in *San Remo Hotel v. City and County of San Francisco*, 27 Cal. 4th 643, 663–664 (2002), the court found

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[12] *See* California Coalition for Rural Housing & Non-Profit Housing Association of Northern California, *Inclusionary Housing In California; 30 Years of Innovation* (2003).

[13] *Id*. at 30-35.

[14] *See, e.g*., Kautz, B., *In Defense of Inclusionary Zoning; Successfully Creating Affordable Housing*, 36 U.S.F. L. Rev. 971, 977 & 1012 (2002) (Inclusionary housing ordinances are defensible if drafted to closely resemble ordinary zoning ordinances.); California Affordable Housing Law Project and Western Center on Law and Poverty, *Inclusionary Zoning: Legal Issues*, (December 2002) (Recommending that ordinances be based on the community's need for affordable housing as evidenced by their general plan housing elements, fair-share regional housing needs, HUD data and other information.)

that the ordinance in question could only be upheld if it had a reasonable relationship to the "deleterious public impact of the development." *Patterson*, 171 Cal. App. 4th at 897–98. After careful evaluation of the evidence relied on by the City, the court concluded that the City had failed to show that its affordable housing in-lieu fee was reasonably related to the impact either of the plaintiff's development specifically or of new residential development generally. 171 Cal. App. 4th at 899.

In *Palmer*, the appellate court held that the City's requirement that developers of new rental housing set aside and rent a percentage of the units at rates affordable to lower-income households conflicted with the Costa Hawkins Act (Civil Code §§ 1954.50 *et seq*.). The Costa Hawkins Act permits developers to set the initial rents for both newly constructed and voluntarily vacated units. The court found that obligating the building owner to provide affordable housing at regulated rents was "clearly hostile" to the right under Costa-Hawkins to establish the initial rental rate for the apartment units. The court also concluded that the option of paying an in-lieu fee did not save the inclusionary requirement because payment of the fee was "inextricably intertwined" with the mandate to impose rent restrictions.

D. Post *Palmer* and *Patterson* Developments.

In order to avoid running afoul of the Costa Hawkins Act, as applied in *Palmer*, some municipalities, including San José, have adopted or are considering adopting "affordable housing fees" for rental housing. In contrast to the in-lieu fees invalidated in *Palmer* as "inextricably intertwined" with the rent ceilings, these fees are expressly characterized as impact fees intended to mitigate "the impact of new market rate housing development on the demand for affordable housing."[15]

At the same time, in implicit recognition of the difficulties in establishing a legally sustainable connection between new residential development and the need for affordable housing, many municipalities have continued to characterize (or recharacterize) their inclusionary housing requirements as something other than development exactions. On the advice of counsel or at the

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[15] Keyser Marston Associates, Inc. Residential Nexus Analysis – City of San José (June 2014) at 1 (available at http://www.sanJoséca.gov/DocumentCenter/View/32877) ("KMA--San José); *see also* RSG, *Nexus Study & Fee Analysis Summary – City of San Carlos* (Feb. 2, 2010) , Appendix 1:2 ("To comply with *Palmer/Sixth Street Properties v. City of Los Angeles*, the revised BMR Ordinance requires developers of rental housing to pay an affordable housing impact fee and does not require the provision of affordable rental housing.") (available at: http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0CCQQFjAB&url=http%3A%2F%2Fwww.21elements.com%2FDownload-document%2F492-San-Carlos-Nexus-Study-Fee-Analysis.html&ei=GrXeU-7YFsekigLt0oGQDw&usg=AFQjCNENQomLUKYgifm2iRfUwAMbL8Q6jw&bvm=bv.72197243,d.cGE)

urging of affordable housing advocates,[16] they have continued to maintain, since *Palmer* and *Patterson*, that inclusionary housing requirements are not fees, dedications or other exactions subject to the statutory and constitutional constraints governing such requirements, but rather are simply land use measures similar to other zoning regulations governing height, setbacks, etc., adopted under the local government's police power, and thus accorded a highly deferential standard of judicial review. They have accordingly disclaimed any need to demonstrate any relationship—reasonable or otherwise—between the housing mitigation requirements and the deleterious impacts of residential development under *San Remo* or *Patterson*. As one widely circulated paper on the topic asserted:

> Communities and advocates must confront head-on the misplaced view advanced by some after *Patterson*—that inclusionary housing obligations and in-lieu fees are a type of exaction required to be strictly related to the projected need for new affordable housing created by new housing development rather than land use regulations related to *the community's legitimate desire to accommodate its critical existing and projected needs for affordable housing*, to provide opportunities for households of all income levels and to affirmatively further integration and other fair housing goals.[17]

Consistent with this approach, despite having commissioned and approved residential nexus studies purporting to validate inclusionary housing fees on rental housing as development exactions, many municipalities have continued to insist either that (1) their *for-sale* affordable housing set asides and in-lieu fees do not constitute development exactions, but are merely

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[16] See Kautz, B., *Life After Palmer: What's Next? Local Responses to Palmer and Patterson*. Paper presented to League of California Cities, May 4, 2011 Opening General Session ("However, until the issue is resolved, we continue to advise clients to justify and defend their ordinances as land use controls that may be adopted based on the public health, safety, and welfare, with the nexus study providing only a backup to oppose a claim that the requirements must be justified by such a study."), available at: http://www.cacities.org/getattachment/802e4824-6f21-4dc5-ab33-181930c230ed/5-2011-Spring-Barbara-Kautz-Life-After-Palmer_-(1).aspx; Rawson, M., *Inclusionary Housing After Palmer and Patterson: Alive & Well in California* (California Affordable Housing Law Project, May 2010) (Recommending that municipalities not revise inclusionary housing fees based on nexus studies, but continue to characterize them as police-power land use regulations subject to deferential review under constitutions and statutes), available at: http://pilpca.org/wp-content/uploads/2010/10/Inclusionary-Zoning-After-Palmer-Patterson-7-11-10.pdf

[17] Rawson, *Inclusionary Housing after Palmer and Patterson*, p.4 (emphasis added).

zoning regulations intended to ensure a supply of affordable housing;[18] and/or (2) that *neither* their in-lieu fees nor their affordable housing impact fees constitute exactions subject to the reasonable-relationship standard.

The latter approach is illustrated by the City of Walnut Creek. In 2010, in the wake of the *Palmer* and *Patterson* decisions, the City commissioned a residential nexus study by Keyser Marston "to estimate and quantify the nexus between new residential development in Walnut Creek and the new demand for affordable housing that would be caused by that development."[19] The City's inclusionary housing ordinance, however, characterizes the fee on for-sale housing as an "in-lieu fee" and the fee on rental housing as an "impact fee." It provides that developments with for-sale units shall either set aside the number of inclusionary units or pay an in-lieu fee. City of Walnut Creek Mun. Code § 10-2.3.903(A) ["ownership projects shall either include the number of inclusionary units required under Section 10-2.3.904 or, if applicable, pay the in-lieu fee required under Section 10-2.3.905]. Rental units, on the other hand, must pay an "affordable housing impact fee." *Id,* § 10-2.3.903(B) ["rental projects shall pay an affordable housing impact fee, if such a fee has been adopted, upon issuance of a building permit for each dwelling unit in the rental project."]. Yet the same ordinance states:

> Nothing in this chapter shall deem or be used to deem the impact and in-lieu fees authorized pursuant to this section as an ad hoc exaction, as a mandated fee required as a condition to developing property, or as a fee subject to the analysis in *Building Industry Association of Central California v. City of Patterson*, 171 Cal.App.4th 886 (2009). Any in-lieu fee adopted by the City Council is a menu option that may serve as an alternative to the on-site housing requirements for ownership projects set forth in this Article.

Other municipalities, including San José, have similar or identical language in their inclusionary housing ordinances. *See, e.g.*, City of San José Mun. Code § 5.08.020 ("Nothing in this chapter shall deem or be used to deem the impact and in-lieu fees authorized pursuant to this section as . . . a mandated fee required as a condition to developing property, or as a fee subject to the analysis in *Building Industry Association of Central California v. City of Patterson*, 171 Cal. App. 4th 886 (2009)).")[20]

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[18] KMA – San José at 8 ("The proposed fee is not an inclusionary fee; it is limited to recouping the impacts shown in the study consistent with the Mitigation Fee Act.")

[19] Staff Report to Walnut Creek City Council (Oct 19, 2010) at 2 (available at: http://walnutcreek.granicus.com/MetaViewer.php?view_id=2&clip_id=1182&meta_id=46724)

[20] *See also* City of San Carlos Mun. Code § 18.16.030 (A)(4) ("Nothing in this chapter or Chapter 18.17 shall deem or be used to deem the in lieu fee authorized pursuant to subsection

And most recently, in light of *Sterling Park* and the grant of review in *CBIA v. City of San José*, some cities (including Hayward and Fremont) have instructed their consultants to include analyses using the 13-step methodology to provide a "post hoc" nexus justification for existing inclusionary zoning requirements in their updated residential nexus analyses.

The current position of many municipalities can thus be summarized as follows:

1. Inclusionary housing fees imposed on *for-sale* housing are fees in lieu of zoning regulations intended to address the community's need for affordable housing, not impact fees to address the impact of new development;
2. Inclusionary housing fees imposed on *rental* housing are development impact fees, not fees in lieu of zoning regulations;
3. Inclusionary housing fees -- whether on for-sale or rental housing -- are not subject to the reasonable relationship standard in *Patterson* and *San Remo*;
4. But if such fees *are* subject to the reasonable relationship standard, they meet that standard because the need for affordable housing is created by new residential housing.
5. If inclusionary zoning itself is an exaction rather than a traditional zoning ordinance, it too meets that standard based on the same methodology used to justify affordable housing impact fees.

This stance, which even some municipal attorneys have acknowledged as problematic,[21] reflects the intellectual and legal tension between the effort to characterize a subset of inclusionary housing requirements as "impact fees" and the longstanding acknowledgement that affordable housing needs are generated by broader social and economic forces, not by new residential development, and should be justified based on the community's desire to provide housing for all income segments.

(A)(3) of this section as . . . as a mandated fee required as a condition to developing property, or as a fee subject to the analysis in *Building Industry Association of Central California v. City of Patterson*, 171 Cal.App.4th 886 (2009). Any in lieu fee adopted by the City Council is a menu option that may serve as an alternative to the on-site below-market rate housing requirements set forth in this chapter."); City of Concord Dev. Code § 122-579(d)(4) (same).

[21] *See* Seltzer, A. *Home Sweet Home? Legal Challenges to Inclusionary Ordinances and Housing Elements Action Apartment Association v. City of Santa Monica*, League of California Cities Conference (Sept. 2009) (available at: http://www.cacities.org/getattachment/f40e9c19-625e-4ce3-ba6d-ccf00777d1cd/9-2009-Annual-ALAN-SELTZER_Home-Sweet-Home-Action.aspx) ("The best defense of IHOs may be for cities to characterize affordable ownership housing obligations and an "*Ehrlich*" in lieu fee for such development as traditional zoning, exempt rental housing from affordability requirements under Costa-Hawkins, and impose an MFA impact fee instead on rental housing. This strategy -- distinguishing an "*Ehrlich*" in lieu fee from an MFA impact fee – will face difficulties post- *Patterson*, as the nexus study needed to justify mitigation of rental housing impacts would likely guide and be confused with the "*Ehrlich*" inclusionary ownership housing in lieu fee.")

IV. APPLICABLE LAW

A. The Mitigation Fee Act and *San Remo*

The Mitigation Fee Act, Cal. Govt. Code, §§ 66000–66025 extensively regulates the adoption and imposition of development exactions, including requirements that the purpose of the fee must be identified with specificity, and that a "reasonable relationship" must exist between the need for and use of the exaction and the type of development project on which the exaction is imposed. Cal. Govt. Code § 66001(a)(3). Government Code § 66005 provides that when a local agency imposes any fee as a condition of approval of a development project, such a fee cannot exceed the estimated reasonable cost of providing the service or facility for which the fee is imposed. A fee or exaction that exceeds the reasonable cost of providing the facilities or services constitutes a special tax that must be expressly authorized by statute and ratified by a two-thirds vote of the electorate under article XIII A, section 4 of the California Constitution. *See* Govt. Code §§ 66014; 50076–77, 53727; *Bixel Assocs. v. City of Los Angeles*, 216 Cal. App. 3d 1208, 1220 (1989) (invaliding excessive fire hydrant fee as a special tax); *Beaumont Investors v. Beaumont-Cherry Valley Water Dist.*, 165 Cal. App. 3d 227, 238 (1984) (invalidating water system hookup fee as a special tax); *see also Shapell Indus., Inc. v. Governing Bd. of the Milpitas Unified Sch. Dist.*, 1 Cal. App. 4th 218, 235–236 (1998); *Balch Enters., Inc. v. New Haven Unified Sch. Dist.*, 219 Cal. App. 3d 783, 794–795 (1990).

As its legislative history reflects, the Mitigation Fee Act was passed by the Legislature "in response to concerns among developers that local agencies were imposing development fees for purposes unrelated to development projects." *Ehrlich*, 12 Cal. 4th 864; Sen. Local Govt.Com. Analysis of Assem. Bill No. 1600 (1987–1988 Reg.Sess.) p. 1.

The Mitigation Fee Act mandates findings concerning the link between the need for and amount of the fee and the impact of the development projects on which the fee is imposed. In particular, the local agency's governing body must adopt findings demonstrating:

> 1. How there is a reasonable relationship between the *need* for the public facility and the *type* of development project on which the fee is imposed.
> 2. How there is a reasonable relationship between the *amount* of the fee and the cost of the public facility attributable to the development upon which the fee is imposed.

Cal. Govt. Code § 66001(a)(3); *id.* at (b).[22]

[22] Government Code 66001 provides:
(a) In any action establishing, . . . or imposing a fee as a condition of approval of a development project . . . the local agency shall do all of the following:
(1) Identify the purpose of the fee.

Thus, before imposing a fee under the Mitigation Fee Act, the local agency is charged with determining that the amount of the fee and the need for the public facility are reasonably related to the burden created by the development project. If such a fee is challenged, the local agency has the burden of producing evidence in support of its determination. *Homebuilders Assn. of Tulare/Kings Counties, Inc. v. City of Lemoore*, 185 Cal.App.4th 554, 561 (2010) The local agency must show that a valid method was used for imposing the fee in question, one that established a reasonable relationship between the fee charged and the burden posed by the development. *Shapell Industries, Inc. v. Governing Board*, 1 Cal.App.4th at 235.

In addition to its procedural requirements, the Mitigation Fee Act embodies both constitutional and statutory standards against which exactions subject to its provisions must be measured. In *Ehrlich v. City of Culver City*, 12 Cal. 4th 854, 866–67 (1996), the Court held that (1) the term "reasonable relationship" as used in the Mitigation Fee Act "embraces both constitutional and statutory meanings" and should be construed in light of both federal and state constitutional jurisprudence; and (2) that all challenges to exactions, whether on statutory or constitutional grounds, must be channeled through the administrative procedures of the Act. The Court subsequently reaffirmed, in *San Remo Hotel v. City and County of San Francisco*, 27 Cal. 4th 643, 663–664 (2002), that "[a]s a matter of both statutory and constitutional law, [exactions] must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development."

In *San Remo Hotel*, owners of a hotel sued to invalidate a San Francisco ordinance limiting the conversion of residential hotel rooms (usually occupied by low-income tenants) to tourist hotel rooms. The purpose of the ordinance was to preserve the availability of residential hotel rooms for the City's low-income residents who would otherwise have had no viable housing options. To achieve that goal, the ordinance required a hotel converting a residential hotel unit into a tourist unit to replace the residential unit elsewhere, pay a fee in lieu of providing the replacement unit, or take other action that would further replacement. Pursuant to the ordinance, the City issued the hotel owners a conditional use permit authorizing the conversion of hotel rooms only upon compliance with one of those alternatives.

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(2) Identify the use to which the fee is to be put. If the use is financing public facilities, the facilities shall be identified. That identification may, but need not, be made by reference to a capital improvement plan as specified in Section 65403 or 66002, may be made in applicable general or specific plan requirements, or may be made in other public documents that identify the public facilities for which the fee is charged.
(3) Determine how there is a reasonable relationship between the fee's use and the type of development project on which the fee is imposed.
(4) Determine how there is a reasonable relationship between the need for the public facility and the type of development project on which the fee is imposed.
(b) In any action imposing a fee as a condition of approval of a development project by a local agency on or after January 1, 1989, the local agency shall determine how there is a reasonable relationship between the amount of the fee and the cost of the public facility or portion of the public facility attributable to the development on which the fee is imposed.

The California Supreme Court found that, as a legislative enactment, the ordinance was subject to the reasonable relationship standard set forth in the Mitigation Fee Act, which the Court, echoing *Ehrlich*, found to embody both statutory and constitutional law principles. Under this standard, the Court held, "[a]s a matter of both statutory and constitutional law, such fees must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development." *Id.* at 671. The Court concluded that the housing replacement fees did bear "a reasonable relationship to loss of housing ... in the generality or great majority of cases" because (1) the conversion to tourist use directly caused the loss of residential rooms; and (2) the mitigation requirements were limited to the number of rooms lost as a result of plaintiffs' conversion. Writing separately, Justice Baxter emphasized the need to demonstrate that "(1) there is a cause-and-effect relationship between the owner's desired use of the property and the social evil that the fee seeks to remedy, and (2) the fee is reasonably related in both intended use and amount to that social evil." 27 Cal. 4th at 687 (Baxter, J. concurring and dissenting)

The court in *Building Industry Association v. Patterson*, 171 Cal. App. 4th 886, applied these standards in evaluating the inclusionary housing fee under review:

> The affordable housing in-lieu fee challenged here is not substantively different from the replacement in-lieu fee considered in *San Remo*. Both are formulaic, legislatively mandated fees imposed as conditions to developing property, not discretionary ad hoc exactions. (*San Remo*, 27 Cal.4th at 671) We conclude, for this reason, that the level of constitutional scrutiny applied by the court in San Remo must be applied to City's affordable housing in-lieu fee . . . ."

Under this standard, the court ruled, the in-lieu fee could not be sustained unless there was "a reasonable relationship between the amount of the fee, as increased, and "the deleterious public impact of the development." *Id.* (citing *San Remo*, 27 Cal. 4th at 671). The court conducted a careful evaluation of the Fee Justification Study relied on by the City and concluded that it showed no reasonable relationship between the extent of City's affordable housing need and residential development. Accordingly, the court held, the Fee Justification Study did not "support a finding that the fees bore any reasonable relationship to any deleterious impact associated with the project."

B. The Constitutional Overlay – The Fairness Principle

In *Palazzolo v. Rhode Island*, the Supreme Court explained that issues arising under the Takings Clause must be "informed by the *purpose* of the Takings Clause, which is to prevent the 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.'" 533 U.S. 606, 618–619 (2001) (quoting *United States v. Armstrong*, 364 U.S. 40, 49 (1960)) (emphasis added); *accord*, *Lockaway Storage v. County of Alameda*, 216 Cal. App. 4th 161, 183 (2013) ("The takings clause precludes the 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."); *Dep't of Fish and Game v. Superior Court*, 197 Cal. App. 4th 1323, 1359 (2011) (Not forcing a few to bear burdens that in fairness and justice should be borne by the public is the "ultimate goal" of the takings clause).

The Court has applied this fairness principle to development exactions as a special application of the "unconstitutional conditions" doctrine. *Lingle v. Chevron USA. Inc*., 544 U.S. 528, 547 (2005); *Dolan v. City of Tigard*, 512 U.S. at 385; *Nollan*, 483 U.S. at 837. Under this "well-settled doctrine" (*Dolan*, 512 U.S. at 385), a state may not condition the grant of a license, permit or other benefit on the recipient's surrender of a constitutional right.[23] The Supreme Court recently described this as an "overarching principle" under which "government may not deny a benefit to a person because he exercises -- or, as in this case, refuses to surrender -- a constitutional right." *Koontz v. St. Johns River Water Management District*, 133 S.Ct. 2586, 2594 (2013). The doctrine "vindicates the Constitution's enumerated rights by prohibiting the government from coercing people into giving them up." *Id; see also, Perry v. Sinderman,* 408 U.S. 593, 597 (1972) ("[E]ven though a person has no 'right' to a valuable governmental benefit and even though the government may deny him the benefit for any number of reasons, there are some reasons upon which the government may not rely. It may not deny a benefit to a person on a basis that infringes his constitutionally protected interests . . . .")

Both the fairness principle and the unconstitutional conditions doctrine come into play when a condition or exaction imposed in the development approval context lacks a reasonable relationship with the impact of the development. Courts routinely uphold laws requiring property owners to pay fees or bear other exactions when their actions can reasonably be established as the proximate cause of the social problem to be remedied and the fees or exactions are reasonable in relation to the extent of the development's contribution to problem. But where use of property cannot reasonably be shown to be the proximate cause of the problem sought to be addressed, or the exaction is disproportionate to the impact of that use, the regulation runs afoul of both the fairness principle and the unconstitutional conditions doctrine and will be set aside. *See, e.g., Koontz v. St. Johns River Water Mgmt. Dist*, 133 S.Ct. 2586, 2601 (2013) (Government may require permit applicant to mitigate the impacts of a proposed development but may not use

[23] The doctrine has been applied in a variety of contexts, including First Amendment freedom of speech (*Agency for International Development v. Alliance for Open Society International, Inc*., 133 S. Ct. 2321 (2013) [requirement that recipient organizations adopt policy explicitly opposing prostitution to receive federal funding to provide HIV and AIDS programs was unconstitutional condition under First Amendment]); freedom of religion (*Sherbert v. Verner*, 374. U.S. 398 (1963) [state could not deny unemployment benefits to woman whose religion forbade working on the Sabbath]); right of interstate travel (*Shapiro v. Thompson*, 394 U.S. 618 (1969) [conditioning of welfare benefits upon minimum of one year in-state residency penalized fundamental right of interstate travel]); and Fifth Amendment property rights (*Nollan v. California Coastal Commission*, 483 U.S. 825 (1987) [Coastal Commission could not condition building permit on grant of a lateral beach access easement unrelated to the impact of the new construction]).

leverage to go beyond constitutionally established limitations); *Del Monte Dunes v. City of Monterey*, 95 F.3d 1422, 1432 (9th Cir. 1996) (invalidating dedication requirement that was disproportionate to the impact that the property development caused); *Surfside Colony, Ltd. v. Cal. Coastal Comm'n*, 214 Cal. App. 3d 1260, 1269 (1991) (required dedication of a public access to a private beach was unconstitutional because there was no causal nexus between the dedication and the problem of beach erosion); *Rohn v. City of Visalia*, 214 Cal. App. 3d, 1457–57 (1989) (conditioning issuance of building permit on dedication of land for a road improvement was a taking because the development did not cause traffic problems).

Application of the fairness principle in the context of development exactions was explained in *Shapell Indus., Inc. v. Governing Bd. of the Milpitas Unified Sch. Dist.*, 1 Cal. App. 4th 218, 235–236 (1998):

> While it is "only fair" that the public at large should not be obliged to pay for the increased burden on public facilities *caused by new development*, the converse is equally reasonable: the developer must not be required to shoulder the entire burden of financing public facilities for all future users. "[T]o impose the burden on one property owner to an extent beyond his [or her] own use shifts the government's burden unfairly to a private party...." (*Liberty v. California Coastal Com.* (1980) 113 Cal.App.3d 491, 504, 170 Cal.Rptr. 247, fn. omitted.) It follows that facilities fees are justified only to the extent that they are limited to the cost of increased services *made necessary by virtue of the development.* (*Trent, supra*, 114 Cal.App.3d 317, 170 Cal.Rptr. 685; *Russ Bldg. Partnership v. City and County of San Francisco* (1987) 199 Cal.App.3d 1496, 1506, 246 Cal.Rptr. 21. The Board imposing the fee must therefore show that a valid method was used for arriving at the fee in question, "one which established a reasonable relationship between the fee charged and the burden posed by the development." (*Bixel Associates v. City of Los Angeles* (1989) 216 Cal.App.3d 1208, 1219, 265 Cal.Rptr. 347; *Jones*, *supra*, 157 Cal.App.3d 745, 203 Cal.Rptr. 580.) (emphases added)

As the California Supreme Court confirmed in *Ehrlich*, this principle extends beyond financing of public facilities to include any exactions imposed as a condition of approval of development "that divest the developer of money or a possessory interest in property." 12 Cal. 4th at 864. As is also clear from *Koontz v. St. Johns River Water Management District*, 133 S.Ct. 2586 (2013), the principle applies to monetary exactions as well as conditions directly involving real property interests.

C. The Causal Connection – Proximate and Substantial

As the foregoing authorities indicate, central to the requirements of *San Remo* and the Mitigation Fee Act is a showing of the reasonable *causal* relationship between the proposed development and the problem the exaction is designed to address. *San Remo Hotel*, 27 Cal. 4th at 664 (an exaction "must bear a reasonable relationship, in both intended use and amount, to the deleterious public impact of the development"). The mandate that the fee be "reasonably *related*," according to its plain meaning, requires a reasonable causal connection or link between the development and the impact sought to be addressed. See Merriam Webster Dictionary ["related: 1. connected by reason of an established or discoverable relation" http://www.merriam-webster.com/dictionary/related]; *Homebuilders Ass'n of Tulare/Kings Counties, Inc. v. City of Lemoore*, 185 Cal.App.4th 554, 576 (2010) (Ardaiz, J. concurring) ("Section 66000 and 66001 refer to a fee related to the development project. The term 'related' would in its normal usage mean associated with or having a close connection to. I would infer from this that the proposed specific project or class of projects must be a consequence of or have a direct relationship to the proposed development.") (Citation omitted).

In the inclusionary housing context, the causation element is essential to the required finding of a reasonable relationship between the type of development and the existence and extent of the need for affordable housing. If no reasonable causal connection exists between new residential development and affordable housing needs, the agency cannot sustain the burden of establishing that there is a reasonable relationship between (1) the development and the *need* for affordable housing; (2) the development and the *use* of the exaction to provide affordable housing; or (3) the amount or extent of the exaction and the *cost* of the affordable housing attributable to the development. Cal. Govt. Code §§ 66001(a)(3)–(4); *id.* at (b). Without that reasonable causal connection, the exaction becomes an unconstitutional condition.

(1) Proximate Cause in the Takings Context.

Proximate cause analysis, which is routinely employed by courts in a wide variety of contexts including takings law, is appropriate to the determination whether the causal component of the reasonable-relationship standard is satisfied. Proximate causation reflects both "'ideas of what justice demands'" and "'of what is administratively possible and convenient,'" *Anza v. Ideal Steel Supply Corp*., 57 U.S. at 458 (quoting *Prosser & Keeton* § 41, at 264). The proximate cause inquiry works toward answering the constitutional question reflected in the reasonable-relationship test—whether the development is sufficiently connected with the social problem to make it fair and reasonable to require the property owner—as opposed to society as a whole—to address it through mitigation.

In the regulatory takings context, the Supreme Court has stated that courts will use proximate cause concepts to determine if the government regulation caused the property owners' losses:

> [W]e have frequently observed that whether a particular restriction will be rendered invalid by the government's failure to pay for any

> losses *proximately caused by it* depends largely upon the particular circumstances in that case. (Emphasis added)

Penn. Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978) (quoting *United States v. Cent. Eureka Mining Co*., 357 U.S. 155, 168 (1958); *see also Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency*, 535 U.S. 302, 344–45 (2002) ("[O]rdinary principles of proximate cause govern the causation inquiry for takings claims.") (Rehnquist, J. dissenting). In *Esplanade Props., LLC v. City of Seattle*, 307 F.3d 978, 984 (9th Cir. 2002), the court, confirming that plaintiffs in a takings claim must establish proximate causation, recognized that "little discussion of a 'causation' requirement in any of the case law involving regulatory takings" is "due to nothing more than the fact that, in most regulatory takings cases, there is no doubt whatsoever about whether the government's action was the cause of the alleged taking."

The use of the proximate cause in cases arising under the Takings Clause has also been explicitly endorsed by the California Supreme Court. *See, e.g., Locklin v. City of Lafayette*, 7 Cal.4th 327, 368 (1994); *Belair v. Riverside County Flood Control Dist*., 47 Cal. 3d 559 (1988); *Albers v. County of Los Angeles*, 62 Cal. 2d 250, 262 (1965) ("[A]ny actual physical injury to real property proximately caused by the improvement . . . is compensable under article 1, section 14 . . . ."). This principle has been widely cited by California courts in inverse condemnation cases involving public improvements.

California courts have also emphasized the close connection between the proximate cause requirement and the constitutional fairness doctrine, which holds that property owners should not have to bear burdens that, in fairness, should be borne by society. Courts have referred to this policy as the "loss distribution' premise." *See Holtz v. Superior Court* (1970) 3 Cal. 3d 296, 303–304. *See also Pac. Bell v. City of San Diego*, 81 Cal. App. 4th 596, 607 (2000) ("[T]he fundamental policy underlying inverse condemnation is to distribute the costs of the public benefit among those benefited by the public improvement rather than imposing a disproportionate burden on the person damaged by the operation of the improvement.") The California Supreme Court has explained that, in takings cases, the "general rule of compensability [does] not derive from statutory or common law tort doctrine, but instead [rests] on the construction ... of our constitutional provision . . . Article I, section 14:"

> The decisive consideration is whether the owner of the damaged property if uncompensated would contribute more than his proper share to the public undertaking. In other words, the underlying purpose of our constitutional provision in inverse—as well as ordinary—condemnation is to distribute throughout the community the loss inflicted upon the individual by the making of public improvements: to socialize the burden . . . —to afford relief to the landowner in cases in which it is unfair to ask him to bear a burden that should be assumed by society.

3 Cal. 3d 296at 303 (citations omitted); *see also Albers v. County of Los Angeles*, 62 Cal.2d 250, (1965) (Fundamental policy basis for the constitutional requirement of just compensation is a consideration of "whether the owner of the damaged property if uncompensated would contribute more than his proper share to the public undertaking.")

In *Belair v. Riverside County Flood Control Dist*., 47 Cal. 3d 550, 558–59 (1988), the Court confirmed that inverse condemnation liability requires a showing of proximate cause, and clarified that this required a showing of "a *substantial* cause-and-effect relationship excluding the probability that other forces alone produced the injury." (Emphasis added) Under this test, when the activity in question merely contributes to the injury, proximate cause is established only if the injury occurred in substantial part because of the activity. *Id*. at 559–560; *accord*, *Biron v. City of Redding*, 225 Cal. App. 4th 1264, 1279 (2014); *Souza v. Silver Dev. Co*., 164 Cal. App. 3d at 171; *Gutierrez v. County of San Bernardino*, 198 Cal. App. 4th 831, 836 (2011) ("To be a proximate cause, the design, construction or maintenance of the improvement must be a substantial cause of the damage.").

(2) Proximate Cause in Other Contexts.

Courts have also employed proximate cause principles in other non-tort contexts, using the same standards of reasonableness and fairness to place limits on the extent to which a party will be held legally liable or responsible for an alleged impact. For example, the Supreme Court has held that proximate cause principles are appropriate to limit the scope of liability for antitrust violations. *Associated General Contractors of California, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 535–536 (1983). In holding that the plaintiffs could not maintain their antitrust action, the high court stressed, among other factors, the "indirectness of the asserted injury." 459 U.S. at 540. Focusing on the "chain of causation" between the plaintiffs' injury and the alleged antitrust violation, the Court found "that any such injuries were only an indirect result of whatever harm may have been suffered" by parties that lost business due to the defendants' conduct. *Id*. at. 540–541.

The Supreme Court has also used the proximate cause concept to limit the reach of impacts that agencies must consider (and that project proponents must provide mitigation for) under the National Environmental Protection Act ("NEPA"). *See, e.g., Dep't of Transp. v. Pub. Citizen*, 541 U.S. 752, 767 (2004) (analogizing "reasonably close causal relationship" inquiry for defining "indirect effects" in NEPA context to proximate cause inquiry in tort law, and holding that an agency with no discretion or ability to prevent a certain effect due to its limited statutory authority, cannot be considered a legally relevant "cause" of the effect).[24]

[24] Federal courts have also employed proximate cause principles in applying other environmental statutes. *See, e.g., United States* v. *West of Eng. Ship Owner's Mut. Prot. & Indem. Ass'n (Lux.)*, 872 F.2d 1192, 1198–1200 (5th Cir. 1989) (Federal Water Pollution Control Act); *Benefield v. Exxon Corp.*, 959 F.2d 805, 807 (9th Cir. 1992) (Trans-Alaska Pipeline Authorization Act).

In *Metropolitan Edison Co. v. People Against Nuclear Energy*, 460 U.S. 766, 774 (1983), the Court invoked proximate cause concepts in holding, under NEPA, that the Nuclear Regulatory Commission did not have to consider whether the risk of nuclear accident would cause harm to psychological health and well-being of community surrounding nuclear plant because "the element of risk lengthens the causal chain beyond the reach of NEPA." The Court reasoned that NEPA requires "a reasonably close causal relationship between a change in the physical environment and the [prospective] effect at issue," which it interpreted as being "like the familiar doctrine of proximate cause from tort law." 460 U.S. at 776 (citing W. Prosser, *Law of Torts* ch. 7 (4th ed. 1971)). This was necessary to limit the drain on "time and resources" that would result if an agency were forced to examine attenuated effects. *Id.* at 774. The Court subsequently reiterated, in *Department of Transportation v. Public Citizen*, 541 U.S. 752 (2004), that "a 'but for' causal relationship is insufficient to make an agency responsible for a particular effect," 541 U.S. at 767, and therefore insufficient to require the agency to analyze that effect under NEPA.

The application of proximate cause in NEPA is particularly instructive for development fees and exactions. Both NEPA and exactions place obligations on parties to mitigate for the possible effects of their actions. In both of these contexts, the prudential limitations of proximate cause are necessary to "draw a manageable line between those causal changes that may make an actor responsible for an effect and those that do not." *Dep't of Transp. v. Pub. Citizen*, 541 U.S. at 767.

Courts have also imported the proximate cause concept into the Endangered Species Act ("ESA") to place a reasonable limit on the imposition of legal responsibility on property owners for the impacts of their land use activities on threatened and endangered species. *Babbitt v. Sweet Home Communities.*, 515 U.S. 687 (1995).[25] *Sweet Home* involved § 9 of the ESA, which forbids the "take" of an endangered or threatened species. Although this provision does not expressly use the terms "cause" or "proximate cause," the Court found it appropriate to use "ordinary requirements of proximate causation and foreseeability." 515 U.S. at 697 n.9. Both the concurring and dissenting opinions agreed that the use of proximate cause principles was appropriate in the ESA context to cut off property owner responsibility in the face of a lengthy chain-of-events theory of liability. 515 U.S. at 712 (O'Connor, J., concurring); *id.* at 732 (Scalia, J., dissenting) ("I quite agree that the statute contains" a proximate cause requirement.). As

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[25] In *Cascadia Wildlands v. Kitzhaber*, 911 F. Supp. 2d 1075, 1084 (D. Or. 2012), in concluding that a plaintiffs' ESA claim lacked the necessary showing of proximate cause, the court stated:

> To establish proximate causation, plaintiffs must still present a direct relation between the injury asserted and the injurious conduct alleged, and the link between the two cannot be too remote, purely contingent, or indirect.

Justice O'Connor further explained, application of proximate cause "depends to a great extent on considerations of the fairness of imposing liability for remote consequences." *Id*.

A very recent and instructive example of the use of proximate cause in the ESA context occurred in *The Aransas Project v. Shaw*, No. 13-40317, 2014 WL 2932514 (5th Cir., June 30, 2014). There, the Fifth Circuit Court of Appeals held that the Texas Commission on Environmental Quality ("TCEQ") was not responsible for the deaths of endangered whooping cranes based on issuance of permits to withdraw water from rivers that sustained whooping crane habitat, finding that "the district court either misunderstood the relevant liability test or misapplied proximate cause when it held the state defendants responsible for remote, attenuated, and fortuitous events following their issuance of water permits."

The appellate court emphasized that "[p]roximate cause and foreseeability are required to affix liability for ESA violations," and observed that "[n]owhere does the [district] court explain why the remote connection between water licensing, decisions to draw river water by hundreds of users, whooping crane habitat, and crane deaths that occurred during a year of extraordinary drought compels ESA liability." It reliance on *Sweet Home*, the court rejected the lower court's causation analysis, concluding that "[t]he lack of foreseeability or direct connection between TCEQ permitting and crane deaths is also highlighted by the number of contingencies affecting the chain of causation from licensing to crane deaths. The contingencies are all outside the state's control and often outside human control." These included water use by and availability from other sources, and "even more unpredictable and uncontrollable" forces of nature, including "weather, tides and temperature conditions," which "dramatically affect[ed]" conditions in the subject estuary. The court concluded that "[f]inding proximate cause and imposing liability on the state defendants in the face of multiple, natural, independent, unpredictable and interrelated forces affecting the cranes' estuary environment goes too far."

Like NEPA and the ESA, CEQA limits the range of impacts that agencies must consider and mitigate and these limits have incorporated proximate cause principles. CEQA does not require agencies to consider impacts that are "speculative or unlikely to occur." 14 Cal. Code Regs. § 15064(a)(3). Under CEQA,

> An agency need not devote itself to an extended discussion of the environmental impact of alternatives "remote" from reality such as those which are of speculative feasibility or could only be implemented after significant changes in governmental policy or legislation.

Residents Ad Hoc Stadium Comm. v. Bd. of Trustees, 89 Cal. App. 3d 274, 287 (1979); *see also Friends of the Eel River v. Sonoma County. Water Agency*, 108 Cal. App. 4th 859, 875 (2003) (The possibility that project approval might affect future action by another agency on a different proposal need not be analyzed under CEQA).

(3) Proximate Cause Standards

Proximate cause analysis has two components, both of which must be established for a legally sustainable relationship to exist. *Jackson v. Ryder Truck Rental, Inc.*, 16 Cal. App. 4th 1830 (1993). The first question is whether there is a *substantial* cause-and-effect relationship between the act or omission and the harm. *Mitchell v. Gonzales*, 54 Cal. 3d 1041, 1049 (1991), "The proper rule for such situations is that the defendant's conduct is a cause of the event because it is a material element and a substantial factor in bringing it about." *Id.* at 1052; *Vecchione v. Carlin*, 111 Cal. App. 3d 351, 359 (1980); Prosser & Keeton on Torts (5th ed. 1984) § 41, pp. 266–267. The second issue is whether the party's conduct was closely enough related to the harm that the defendant *should* be held responsible. "This second component of proximate cause, which asks a policy question, has been termed the 'normative or evaluative element' of proximate cause. *Jackson v. Ryder Truck Rental, Inc.*, 16 Cal. App. 4th at 1847 (quoting *Mitchell v. Gonzalez*, 54 Cal. 3d at 1056 (1991) (Kennard, J. dissenting); *see also Evan F. v. Hughson United Methodist Church*, 8 Cal. App. 4th 828, 834–835 (1992).

In *PPG Industries v. Transamerica Insurance Co.*, 20 Cal. 4th 310 (1999), the California Supreme Court explained that the reason for the second component is that without some policy limitation on legal responsibility, the chain of causation can stretch both backwards and forwards, potentially resulting in unlimited liability. *Id.* at 315. The Court quoted with approval Justice Traynor's observation that proximate cause "is ordinarily concerned, not with the fact of causation, but with the various considerations of policy that limit an actor's responsibility for the consequences of his conduct." *Id.* quoting *Mosley v. Arden Farms Co.*, 26 Cal. 2d 213, 221 (1945) (Traynor, J., concurring).

Proximate cause has been employed so widely for so long because, as both the Supreme Court and the California Supreme Court have recognized, the alternative—mere "but-for" causation—is no alternative at all because "'the consequences of an act go forward to eternity, and the causes of an event go back to the dawn of human events, and beyond.'" *Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 838 (1996) (quoting W. Keeton et al., *Prosser and Keeton on the Law of Torts* § 41, at 266 (5th ed. 1984)); *PPG Indus.*, 20 Cal. 4th at 324.

"The chief and sufficient reason for [proximate cause] is to be found in the impossibility of tracing consequences through successive steps to the remote cause, and the necessity of pausing in the investigation of the chain of events at the point beyond which experience and observation convince us we cannot press our inquiries with safety." *Associated Gen. Contractors of Cal.*, 459 U.S. 519, 532 n.24 (1983).

D. The Role of Expert Opinion.

Proximate cause requirements cannot be dispensed with based simply upon an expert's assurance -- without empirically verifiable evidentiary support -- that the requisite factual connection exists between the act or event and the impact. Courts, for example, will not allow juries to rely on expert testimony unless it contains "a reasoned explanation illuminating why the *facts* have convinced the expert, and therefore should convince the jury, that it is more probable than not the [] act was a cause-in-fact of the plaintiffs injury." *Jennings v. Palomar Pomerado Health Systems, Inc.*, 114 Cal.App.4th 1108, 1118 (2003) ("[P]roffering an expert opinion that there is some theoretical possibility of the negligent act could have been a cause in fact of a particular injury is insufficient to establish causation." *Id.* (citations omitted; emphasis added.)

For example, an expert's opinion based on assumptions of fact without evidentiary support, or on speculative or conjectural factors, has no evidentiary value and may be excluded from evidence. *See, e.g., Pacific Gas & Electric Co. v. Zuckerman*, 189 Cal.App.3d 1113, 1135 (1987); *Lockheed Martin Corp. v. Superior Court*, 29 Cal.4th 1096, 1110–1111 (2003); *City of San Diego v. Sobke*, 65 Cal.App.4th 379, 396 (1998). Likewise, when an expert's opinion is conclusory because unaccompanied by a reasoned explanation connecting the factual predicates to the ultimate conclusion, "the opinion has no evidentiary value because an expert opinion is worth no more than the reasons upon which it rests." *Kelley v. Trunk*, 66 Cal.App.4th 519, 523–525 (1998). As a result, "an expert's opinion that something could be true if certain assumed facts are true, without any foundation for concluding those assumed facts exist . . . does not provide assistance to the jury because the jury is charged with determining what occurred in the case before it, not hypothetical possibilities." *Bushling v. Fremont Medical Center*, 117 Cal.App.4th 493, 510 (2004); *Jennings*, 114 Cal.App.4th at 1117-18 ("An expert who gives only a conclusory opinion does not assist the jury to determine what occurred, but instead supplants the jury by declaring what occurred.").

For these reasons, an expert opinion that there is a *theoretical* possibility that an act could have been a cause-in-fact of a particular event is insufficient to establish a legally cognizable showing of causation. *Saelzler v. Advanced Group 400*, 25 Cal.4th 763, 775–776 (2001); *accord, Leslie G. v. Perry & Associates*, 43 Cal.App.4th 472, 487 (1996). Instead, the plaintiff must offer an expert opinion that contains a reasoned explanation illuminating why the facts have convinced the expert, and therefore should convince the jury, that it is more probable than not that the act was a cause-in-fact of the injury. *Jennings*, 114 Cal.App.4th at 1118.

Similarly, an expert may not rely on a model or methodology that cannot be empirically validated and is not reasonably established in the scientific or other expert literature. Evidence Code section 801 limits expert testimony to a matter "of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates."[26]

[26] Similar rules prevail in federal court. Under the Federal Rules of Evidence, before an expert can testify to any "scientific, technical, or other specialized knowledge," a federal district court must be satisfied that "the testimony is based upon sufficient facts or data, the testimony is the

Courts of appeal have consistently recognized the duty to examine the basis for expert opinions and exclude testimony that lacks an empirical foundation and is not generally accepted in the scientific or expert community. *See, e.g., Pacific Gas & Electric v. Zuckerman*, 189 Cal. App. 3d 1113 (1987). "Where an expert bases his conclusion upon assumptions . . . which are not reasonably relied upon by other experts, or upon factors which are speculative, remote or conjectural, then his conclusion has no evidentiary value," and it is proper to preclude a jury from hearing that testimony. *Pacific Gas*, 189 Cal. App. 3d at 1135. As another court observed: "Like a house built on sand, the expert's opinion is no better than the facts on which it is based." *Kennemur v. State of California*, 133 Cal. App. 3d 907, 923 (1982).

As with a court, an agency can and should disregard expert testimony that lacks an adequate factual foundation or is not based upon a generally accepted methodology. For example, "an expert's opinion which says nothing more than 'it is reasonable to assume' that something 'potentially ... may occur'" but has no basis in fact does not constitute substantial evidence that can reasonably be relied on by a public agency. *See Apartment Association of Greater Los Angeles v. City of Los Angeles*, 90 Cal.App.4th 1162, 1173-1176 (2001). *See also* Pub. Resources Code, § 21080(e)(2) ("Substantial evidence includes expert opinion *supported by fact* [and] not . . . unsubstantiated opinion or narrative.") (emphasis added); *Pala Band of Mission Indians v. County of San Diego*, 68 Cal.App.4th 556, 580 (1998) (Letter based on unsubstantiated opinion did not constitute substantial evidence); *Lucas Valley Homeowners Ass'n v County of Marin*, 233 Cal. App. 3d 130 (1991) (Expert testimony by real estate agent regarding potential decline in property values was not substantial evidence because it was an imprecise opinion without supporting verifiable data such as comparables); *Citizens Comm. to Save Our Village v City of Claremont*, 37 Cal. App. 4th 1157, 1170 (1995) (no factual foundation for architect's letter claiming a historically significant landscape plan had been implemented on project site); *Gentry v City of Murrieta*, 36 Cal. App. 4th 1359, 1422 (1995) (letter from engineering professor about groundwater and erosion impacts was not substantial evidence because it was not based on an adequate factual foundation). An agency also has authority to discount evidence provided by an expert on the ground that the foundational assumptions are simply not credible. *Bowman v City of Berkeley*, 122 Cal. App. 4th 572, 583 (2004).

V. APPLICATION

In contrast to other development impacts for which fees or other mitigation measures are commonly imposed—such as traffic, sewer systems, schools, etc.—there is no intuitively obvious connection between new residential housing and the need for new affordable housing. In fact, both common sense and economic analysis supports the opposite conclusion—that

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product of reliable principles and methods, and the witness has applied the principles and methods reliably to the facts of the case." Fed. R. Evid. 702; *see also Daubert v. Merrell Dow Pharmaceuticals, Inc*., 509 U.S. 579 (1993).

provision of new housing may alleviate the need for affordable housing as people move from older, less expensive homes to new homes. [27]

The residential nexus analyses do little to dispel this. While there is some variation in the methodology employed in these studies, they share common assumptions about the links in the chain of reasoning in what may best be described as an economic hypothesis. A compressed summary of the postulated hypothetical chain[28] is as follows:

- New market-rate units are constructed.
- New people (or "households") occupy the market-rate units and represent net new income in the community.
- The new households spend a percentage of that income on goods and services in the community.
- The new expenditures in the community create an economic stimulus.
- The economic stimulus results in job growth in the community.
- The jobs attract new people to the community.
- Because the jobs generated are at different compensation levels, there is a corresponding variation in the incomes of the new people.
- The new people generate a demand for new housing in the community.
- The new people with lower-paying jobs generate a demand for low-income housing.
- Therefore, the new residential development may be held responsible for the lower-income housing.

At virtually every step, additional assumptions are made about factors such as household income, type, extent and location of expenditure of disposable income, multiplier effects, type and extent of new job generation, compensation, housing demand, size and income of new households, relationship to area median income, housing subsidies, commuting patterns and other variables.

The residential nexus studies do not assess, rely on, attempt to controvert or even mention the substantial body of governmental and academic literature and supporting data identifying the

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[27] Powell, B. and E. P. Stringham, *The Economics of Inclusionary Housing Reclaimed': How Effective Are Price Controls?* 33 Fla. St. U. L. Rev. 471, 496 (2005) (Economic studies show that as new homes are occupied, more housing becomes available at all income levels); Lansing, J., et al., *New Homes and Poor People* at 38-40 (Study of home sales in 13 cities showed that each new home generated average of 3.5 moves and that "any policy which increases the total supply of housing will be beneficial. The working of the market for housing is such that the poor will benefit from any actions which increase the supply in the total market.")

[28] *See, e.g., Residential Nexus Analysis, City of San José*, Keyser Marston Associates, Inc. (June 2014) at p.9.

root causes of affordable housing needs. These data, studies and reports indicate that the lack of affordable housing is the result of a complex blend of factors, including restrictive zoning and growth controls, excessive impact fees, complex environmental regulations, multifamily housing restrictions, and NIMBYism. A consistent theme of these studies and reports is that affordable housing needs are a compound social problem that must be addressed through a comprehensive range of policy responses and measures (including streamlining the development approval process, eliminating restrictive zoning regulations, providing financial incentives, counteracting NIMBYism, reducing the complexity and uncertainty of environmental requirements).

Unlike those studies and reports, which evaluate and rely on empirical data (including economic and demographic information) and a large body of existing literature, the residential nexus analyses are neither empirically grounded nor based on any body of established academic, scientific or technical literature. A comprehensive review of potentially relevant sources in 2011 disclosed no literature -- peer-reviewed or otherwise -- supporting the methodology used in the residential nexus analyses. [29]

Thus, in addition to lacking any empirical justification and failing to controvert the large body of academic, technical and governmental literature identifying other causes of affordable housing needs, the residential nexus studies employ a methodology that has not been generally accepted, or even considered, by the academic, scientific or technical community. They rely entirely on a combination of assumptions and modeling to construct a theory under which a market-rate home generates economic forces that create a "need" for a below-market-rate home. But these studies fail to demonstrate that the new housing has any *causative*, as opposed to correlative, relationship with the need for affordable housing. In contrast to traditional academic or scientific studies, in which a theory is tested against empirical data, there is no attempt in the residential nexus studies to evaluate data -- such as the historical correlation between development of market-rate housing and demand for affordable housing -- that would test the validity of the assumptions underlying the residential nexus studies. The assumptions remain just that -- assumptions, ranging from the dubious (such as that every household contains people with similar incomes) to the untenable (such as that every new job within a city generates a new household in that city).

The complex and multifaceted chain of articulated and embedded assumptions in the residential nexus studies is also far too lengthy and attenuated to comport with basic notions of fairness and proximate cause.

First, it is not even clear that the most basic "but-for" causation is present in this analysis. The notion that the new residential development itself "causes" the need for affordable housing rests on a shaky and simplistic foundation that confuses causation with correlation. Economic

[29] Cray, A., *The Use of Residential Nexus Analysis in Support of California's Inclusionary Housing Ordinances: A Critical Evaluation: A report to the California Homebuilding foundation* (Nov. 2011) at 7 (available at http://www.cbia.org/go/linkservid/06D3172D-35C3-4C71-9A9098D439C63874/showMeta/0/).

stimulus, the "multiplier" effect and other factors heavily influence both job creation and the demand for new housing—both market-rate and affordable. The nexus studies do not contain any empirical data demonstrating any causative, as opposed to correlative, relationship between new market-rate housing and the need for affordable housing—the purported link is purely theoretical. "Causation turns on whether the act or event has "created a force or series of forces which are in continuous and active operation up to the time of the harm," and it is not enough simply to "create[] a situation harmless unless acted upon by other forces for which the actor is not responsible." Restatement (Second) of Torts § 433(b). It is not possible to say with any degree of assurance that the residential development—as distinct from independent economic forces—causes any of the events or phenomena in the analytic chain, much less creates forces that, in continuous and active operation, lead to the need for affordable housing. Proximate cause minimally requires that "the probability that other forces alone produced the injury" be excluded. *Biron v. City of Redding*, 225 Cal. App. 4th 1264, 1279 (2014). Because there is nothing to indicate that the demand for affordable housing would not have existed without—and may well have preceded—the construction of the new housing, this most fundamental causal requirement is not satisfied.

Moreover, as discussed in detail above, proximate cause requires that the act or omission constitute a *substantial* cause-and-effect relationship . . . ." *Belair*, 47 Cal. 3d at 558–59. The Restatement explains that the word "substantial" is used to denote the fact that the party's conduct:

> has such an effect in producing the harm as to lead reasonable men to regard it as a cause, using that word in the popular sense, in which there always lurks the idea of responsibility rather than in the so-called "philosophic sense," which includes every one of the great number of events without which any happening would not have occurred. Each of these events is a cause in the so-called `philosophic sense,' yet the effect of many of them is so insignificant that no ordinary mind would think of them as causes.

The length and complexity of the chain of causal reasoning, and the number of variables that are highly sensitive to other factors, forecloses any argument that new residential development has a *substantial* cause-and-effect relationship with the need for affordable housing.[30]

The Restatement lists several considerations in evaluating proximate cause, among which are "the number of other factors which contribute in producing the harm." Causal chains far less tenuous than this one have been rejected under proximate cause principles simply because there are too many assumptions piled upon assumptions. Here, the presence of so many steps in the

[30] *See Cray*, *supra* n. 1, at 41 ("Several issues common among residential nexus analyses call into question the accuracy of the methodology as a whole. Estimates by the various firms are sensitive to minor changes in assumptions, calculations, and data sources, most of which seem to err on the side of inflating inclusionary percentages and in in-lieu fees.")

analysis, any one of which can be heavily influenced in one direction or another by independent variables, renders the ultimate conclusion little more than speculation—the antithesis of the "substantial cause-and-effect" relationship required by law. *See Anza*, 547 U.S. 451 (no proximate cause when a court would have to engage in a "speculative" inquiry").

Even proponents of these nexus studies, in moments of candor, recognize as much:

> Has the need for affordable housing increased in recent years? Yes, it has…. The need has increased recently, particularly in parts of the State such as the San Francisco Bay Area, due to a confluence of several factors. First, the demise of redevelopment and a reduction in federal programs have led to a serious drop in funding available to affordable housing. For example, in Santa Clara County, it has been estimated that total funding available for affordable housing in 2008 (the last 'normal' year) was approximately $126 million. In 2013, the corresponding number was $47 million…. The second factor has been the booming local economy. That has lowered the vacancy rate on rental housing, created a white-hot real estate market for medium- to high-density multi-family housing, but of course, also raised rents. Faber, *Inclusionary Housing Requirements: Still Possible?* (September, 2014, presented at the League of California Cities City Attorneys' Department 2014 Annual Conference)

It is therefore not surprising that in response to the question—"Is it your professional opinion that the [San José] Study establishes a causal relationship between building market rate housing and a quantifiable need for affordable housing or rather a correlative one?"—Keyser Marston refused to provide such an opinion and instead responded: "The City's Consultant prepared the nexus analysis to meet the reasonable relationship standard under the Mitigation Fee Act, and in the Consultant's opinion, the analysis meets that standard."

In addition to failing the first element of the proximate cause requirement—the substantial cause component—the theory of responsibility underlying the residential needs analyses fails the normative/evaluative component since it does not comport with the governing constitutional and statutory policies. The application of proximate cause to development mitigation necessarily embraces the policies of fairness and justice embodied in the state and federal constitutions, which preclude "forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *United States v. Armstrong*, 364 U.S. 40, 49 (1960); *accord, Lockaway Storage v. County of Alameda*, 216 Cal. App. 4th 161, 183 (2013). If, for the reasons discussed above, it is not possible to say with any assurance that residential development is a substantial factor in creating the need for affordable housing, the "reasonable relationship" fundamental to development exactions is absent. The relationship between the development and the need is at best abstract and remote—the product of complex and largely theoretical studies commissioned solely for the express purpose of demonstrating a connection that many of the municipalities have expressly disavowed in their codes and ordinances.

It is also significant that the theory of responsibility underlying these studies has no coherent limiting principle. The low-income employees forecasted by the model may also be unable to afford many basic human needs other than new housing: health care facilities and services; transportation services and facilities; food and clothing; educational facilities and opportunities. Accepting the conclusion of the new generation of residential nexus studies—that local governments may impose on developers of new market-rate housing the responsibility to fund the housing needs of these projected low-income employees—necessarily opens the door to requiring residential developers to fund these other needs. Such a result is neither fair nor just.[31]

The lack of affordable housing has been a critical issue in California for decades. As numerous studies have demonstrated, the paucity of affordable housing is the product of a highly complex interrelationship of economic, political and social factors, including local government resistance, fiscal disincentives, NIMBYism, CEQA, and lengthy permitting procedures. It will exist whether or not there is any new market-rate housing almost surely in a more severe form in the absence of such development. It is a problem that, in fairness, should be addressed, and the costs borne, by society at large, not allocated to builders of market-rate housing based on studies that fail to satisfy the most basic elements of proximate cause.

[31] Proponents of affordable housing exactions often argue that "housing is unique" because, they assert, unlike with other human needs, local governments have a constitutional obligation to provide adequate housing for all of their residents. This is untenable. California cities and counties are required by state law to zone sufficient sites at appropriate densities so that for-profit and non-profit developers have a realistic opportunity build the number of housing units identified in the local government's housing element. They are under no obligation to fund its development or ensure that it gets built. At all events, *Patterson* expressly rejected the argument that state housing law requirements—whatever their scope—allow cities and counties to impose exactions that do not satisfy *San Remo*'s nexus requirements.