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Tim Iglesias
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California Supreme Court
Unanimously Upholds Inclusionary Zoning as Land Use Regulation and Not an Exaction

Tim Iglesias

Introduction

Local governments, housing advocates, and people who need affordable housing won a solid victory in the California Supreme Court’s unanimous opinion in *California Bldg. Indus. Ass’n v City of San Jose* (2015) 61 C4th 435, reported at 38 CEB RPLR 104 (July 2015). In a complex 64-page opinion that is clearly drafted and rigorously argued, the court held that inclusionary zoning is a constitutionally permissible strategy to produce affordable housing and to promote economic integration that is subject to rational basis review and not heightened scrutiny.

The City of San Jose’s ordinance requires all new residential development projects of 20 or more units to sell at least 15 percent of the for-sale units at a price that is affordable to low- or moderate-income households. In the latest of many legal attacks on inclusionary zoning, the California Building Industry Association (CBIA) argued that because inclusionary zoning was an “exaction”—intended to mitigate the negative effects of market rate housing development on the need for affordable housing—the proper standard of review was the heightened scrutiny standard described in *San Reno Hotel v City & County of San Francisco* (2002) 27 C4th 643 (San Reno), reported at 25 CEB RPLR 105 (Apr. 2002). That test would require San Jose to demonstrate a reasonable relationship between the exaction and the deleterious effect of the proposed development on its need for affordable housing. No doubt CBIA’s hopes were buoyed by recent cases. An appellate court, in *Building Indus. Ass’n v City of Patterson* (2009) 171 CA4th 886 (Patterson), reported at 32 CEB RPLR 78 (May 2009), had applied the San Reno test to an inclusionary requirement. In *Sterling Park, L.P. v City of Palo Alto* (2013) 57 C4th 1193 (Sterling Park), reported at 36 CEB RPLR 130 (Nov. 2013), the California Supreme Court itself found an in lieu fee provision of an inclusionary zoning ordinance to be an “exaction” for purposes of the “pay under protest” provisions of the Mitigation Fee Act’s statute of limitations (Govt C §§66020 and 66021).

The California Supreme Court unequivocally rejected CBIA’s interpretation of the ordinance and the law. Instead, the court placed inclusionary zoning squarely in the context of local governments’ long-standing statutory obligation “to make adequate provision for the housing needs of all economic segments of the community” (Govt C §65580(d)) and decided that inclusionary zoning is a type of land use regula-
tion subject to the rational basis test—i.e., that the ordinance bears a real and substantial relationship to a legitimate public interest and is invalid only if it is arbitrary, discriminatory, and without a reasonable relationship to any legitimate public interest. The court found that the ordinance does not impose any exactions making it subject to the unconstitutional conditions doctrine on which CBIA relied, and so that judicial review standard does not apply. Affirming the appellate court below, the court effectively remanded the case to the trial court to determine whether San Jose’s ordinance was valid under the rational basis standard. In a model of judicial excellence, the court also elucidated the meaning of prior inclusionary zoning cases, thereby clarifying California’s law on inclusionary zoning, which had become complex and arguably inconsistent in the last several years. Two concurrences add additional insights.

San Jose is one of more than 170 localities in California that have enacted a mandatory set-aside inclusionary zoning ordinance. Inclusionary zoning is a flexible device each locality can shape to fit its needs and housing market. Government lawyers now have a clear roadmap for enacting inclusionary zoning ordinances that they can be confident will withstand judicial scrutiny in California. Some existing inclusionary ordinances may require tweaking to meet the opinion’s requirements. Still, CBIA may appeal to the U.S. Supreme Court to elicit an expanded application of Koontz v St. Johns River Water Mgmt. Dist. (2013) 570 US ___, 133 S Ct 2586, reported at 36 CEB RPLR 85 (July 2013). Importantly, this case concerned only for-sale inclusionary zoning. Rental inclusionary zoning has been largely stalled by Palmer/Sixth St. Props., L.P. v City of Los Angeles (2009) 175 CA4th 1396 (Paimer), reported at 32 CEB RPLR 136 (Sept. 2009), which found it was preempted by California’s Costa-Hawkins Act. No doubt affordable housing advocates will try to extend this victory by seeking a legislative overturn of Palmer.

Case Background

CBIA challenged San Jose’s ordinance before it took effect, arguing it was invalid on its face because San Jose had failed to provide sufficient evidence in the record to meet the relevant legal standard. The trial court found for CBIA, interpreting the ordinance as amounting to an exaction because it required a “dedication” of property for public purposes or payment of fees in lieu of such property conveyances, thus triggering heightened scrutiny. San Jose had not prepared a “nexus” (or reasonable relationship) analysis showing that building new market rate homes caused or worsened its existing need for affordable housing, which would justify the exaction, so its record did not satisfy that standard. Thus, the court enjoined San Jose from enforcing the ordinance. The court of appeal reversed and remanded the case to the trial court. CBIA sought review by the California Supreme Court to determine the proper standard of review for inclusionary zoning ordinances.

The Supreme Court Opinion

Placing Inclusionary Zoning in the Context of California’s Housing Laws

The opinion begins by reciting the legislature’s 1979 finding that California suffers from a “serious shortage of decent, safe, and sanitary housing which persons and families of low or moderate income ... can afford.” 61 C4th at 441. Recognizing that the ongoing affordable housing crisis has reached “epic proportions” in many areas of the state, the court places inclusionary zoning in the context of several long-standing state laws regulating how local governments must use their land use authority to support the provision of affordable housing.

All California local governments must adopt a general plan to exercise their land use authority constitutionally. Govt C §65300. The general plan must include a housing element that consists of a housing inventory, a housing needs analysis, and a program of plans and policies (including zoning and planning policies) that make “adequate provision for the housing needs of all economic segments of the community, in particular extremely low-, very low-, lower- and moderate-income households.” 61 C4th at 446. The court identified other state housing policies that promote the production of affordable housing, including Govt C §§65913.1 (the least cost zoning law), 65589.5 (the Housing Accountability Act), and 65915 (the density bonus law). The court noted that the legislature had previously adopted statutes mandating inclusionary zoning for both redevelopment areas (Health & & S C §33413(b)(1), (2)(A)(i)) and the coastal zone (Govt C §65590(d)). 61 C4th at 445. The court concluded that the legislature is clearly aware of local inclusionary zoning ordinances and that “existing state legislation is neither inconsistent with nor intended to preempt these local measures.” 61 C4th at 446.

San Jose’s Process and Ordinance

The court recounts in great detail the thoroughness of the City of San Jose’s collaborative process in developing the inclusionary zoning ordinance over a period of several years as a deliberate part of fulfilling its duty under the state’s housing laws. Like most inclusionary zoning ordinances, San Jose’s ordinance requires and incentivizes developers to construct affordable housing units on the same site as the market rate units. The economic incentives include a density bonus (enabling the developer to build more units on a given plot of land than the regular zoning would authorize), a parking space reduction, a minimum setback reduction, and additional financial subsidies and assistance from the city. (California’s density bonus law independently requires cities to offer regulatory relief to developers who build affordable housing units in some situations.) As most inclusionary zon-
ing ordinances do, San Jose's ordinance offers developers alternative ways to comply, including:

- Building affordable units off-site;
- Paying an in lieu fee based on the median sales price of housing units affordable to a moderate-income family;
- Dedicated to the city land of equal value to the in lieu fee; or
- Acquiring and rehabilitating a comparable number of inclusionary units that are affordable to low- or very-low-income households.

The ordinance requires San Jose to create guidelines to ensure that the affordable housing units are not lost when the original buyers sell them and are effectively preserved for at least 45 years. Under the ordinance, as part of the consideration for the privilege of buying an affordable unit, purchasers of such units would be required to agree to maintain the affordability of the units. The ordinance lists some possible documentary means to effect this goal, including granting the city options to purchase. In addition, it requires documents that enable the city to recapture ill-gotten gains if an affordable-unit homebuyer violates her agreement to maintain the affordability of the unit by selling it at market price. Finally, the ordinance allows the city to adjust, reduce, or entirely waive the inclusionary requirement on a showing by the developer that application of the ordinance to its project would violate the takings clause of the U.S. or California Constitution.

**CBIA's Attack**

CBIA never denied San Jose's need for affordable housing. Instead, it presented inclusionary zoning outside the context of the state's housing policies and contested the type of judicial scrutiny that inclusionary zoning must meet as a means to deal with the housing crisis. CBIA's theory was that, despite the city's characterization of its ordinance as an ordinary land use regulation, the court should interpret the ordinance as an exaction intended to mitigate the effect of new market rate housing on the city's need for affordable housing. CBIA argued that a passage in San Remo should be interpreted to require San Jose to demonstrate that its inclusionary zoning requirement is reasonably related to the adverse impacts on the city's affordable housing that are caused by or attributable to the proposed market rate residential development.

**No Exaction—Unconstitutional Conditions Doctrine Does Not Apply**

The court identifies the challenge as sounding in the prong of regulatory takings law called the unconstitutional conditions doctrine, which "imposes special restrictions upon the government's otherwise broad authority to condition the grant of a privilege or benefit when a proposed condition requires the individual to give up or refrain from exercising a constitutional right." 61 C4th at 457. This doctrine derives from the United States Supreme Court's decisions in Nollan v California Coastal Comm'n (1987) 483 US 825, 107 S Ct 3141 (Nollan), reported at 10 CEB RPLR 138 (Aug. 1987), and Dolan v City of Tigard (1994) 512 US 374, 114 S Ct 2309 (Dolan), reported at 17 CEB RPLR 263 (Aug. 1994).

Nollan and Dolan apply when a government regulation requires a developer to dedicate a property interest for public use as a condition of receiving a land use permit in a situation where it would clearly be a taking if the government had simply required the dedication of the property outside the permit process to serve its objective. In Nollan, the property interest was an easement; in Dolan, it was a dedication of a strip of land in fee simple. "Under Nollan and Dolan, the government may impose such a condition only when the government demonstrates that there is an 'essential nexus' and ‘rough proportionality’ between the required dedication and the projected impact of the proposed land use." 61 C4th at 458.

In Koontz v St. Johns River Water Mgmt. Dist. (2013) 570 US __, 133 S Ct 2586 (Koontz), the United States Supreme Court extended the application of the unconstitutional conditions doctrine beyond recognized real property interests to apply to government demands for the payment or expenditure of money. Acknowledging that the scope of Koontz's application to monetary land use permit conditions is "at least somewhat ambiguous" (61 C4th at 459), the California Supreme Court finds that the Nollan/Dolan/Koontz line of cases apply only when the government demands an "exaction," meaning the conveyance by the developer of some identifiable protected property interest to the government for public use as a condition of a land use approval.

Nothing in Koontz suggests that ... Nollan and Dolan would apply where the government simply restricts the use of property without demanding the conveyance of some identifiable protected property interest (a dedication of property or the payment of money) as a condition of approval. It is the governmental requirement that the property owner convey some identifiable property interest that constitutes a so-called "exaction" under the takings clause and that brings the unconstitutional conditions doctrine into play.

61 C4th at 460. The court considers and rejects in turn each of CBIA's contentions regarding how the ordinance requires a conveyance or dedication of a property interest to the city as a condition of development. To CBIA's argument that the requirement to sell some units at below-market prices "divests the owner of the difference, in money, between the market value of the property and the affordable price of the property," the court responds that, given the nature of the attack as a facial challenge, there is no evidence that the ordinance will necessarily reduce a developer's revenue or profit "in the great majority of cases" or in any instance at all. 61 C4th at 466. This is particularly true because of the various economically beneficial incentives that developers who produce affordable units on-site receive under the ordinance. Moreover, the court notes that a reduction in the value of property alone does not amount to a required dedication of
property, since most land use regulations have the effect of diminishing the value of regulated property.

To CBIA's argument that the controls contemplated in the ordinance to preserve the affordability of the inclusionary units constitute an exaction of the developer's property, the court responds that these controls merely place an agreed-on restriction on the units' buyers' use of their property in the future and does not place any restriction—much less impose an exaction—on the developer's property. The San Jose ordinance lists a variety of potential documents, including an option to purchase, that may be used to preserve the affordability of the inclusionary units, but it does not require that any specific one be used. The court distinguishes the requirement in Palo Alto's inclusionary zoning ordinance (challenged in Sterling Park) that "the developer grant the city an option to purchase each affordable housing unit when the unit is up for sale" because this is an identifiable property interest. Cities with inclusionary zoning ordinances that require developers to transfer such property interests to the developer should consider revising their ordinances in light of this holding.

Finally, to CBIA's argument that the ordinance's requirement that the documents preserving the long-term affordability be recorded against the property constitutes a property interest possessed by the city, the court explains that requiring recordation of documents merely provides notice to would-be purchasers of the affordability requirements and does not amount to a property interest.

Under the court's reading of Koontz, if the government offers a developer at least one alternative way to satisfy the condition that does not violate the takings clause, the government has not violated the unconstitutional conditions doctrine. Since the court finds that ordinance's primary requirement of selling 15 percent of the units at an affordable price does not violate the Nollan/Dolan test because it is not an exaction, the court reasons that the ordinance as a whole does not violate the unconstitutional conditions doctrine. The court rejects the contention that San Jose's offering developers alternative methods of compliance (i.e., in lieu fees, land dedication, and off-site construction of the affordable units) as additional choices could transform the ordinance into an exaction. 61 C4th at 468.

Because nothing in the San Jose ordinance requires the conveyance or dedication of any identifiable protected property interest, the ordinance does not amount to an exaction. Because it does not trigger the unconstitutional conditions doctrine as an exaction, that doctrine does not apply to the ordinance; thus, the ordinance does not violate it.

Inclusionary Zoning Is a Land Use Regulation Employing a Price Control

The court finds that the unconstitutional conditions doctrine does not apply to the San Jose ordinance because no provision of the ordinance constitutes an "exaction." Rather, the ordinance's principal requirement restricts the use of property, requiring developers subject to the ordinance to sell 15 percent of their on-site for-sale units at an affordable housing price. In support, the court cites Yee v Escondido (1992) 503 US 519, 532, 112 S Ct 1522, reported at 15 CEB RPLR 198 (May 1992), for the rule that a mobilehome park rent control ordinance was "a regulation of [the mobilehome park owners'] use of their property."

The court reviews California's long tradition of deferential review of localities' exercise of the police power in land use regulations and the wide variety of types of land use regulation to which it has been applied, recalling that "judicial deference is not judicial abdication" because the regulation must have "a real and substantial relation to the public welfare" with a reasonable basis in fact. Citing Associated Home Builders, Inc. v City of Livermore (1976) 18 C3d 582, the court notes the heavy burden of a party challenging the facial validity of a legislatively enacted land use measure to demonstrate that it "lacks a reasonable relationship to the public welfare." 61 C4th at 455.

Although the findings recited in San Jose's ordinance included mitigating the effects of market rate housing developments on the city's need for affordable housing, the court emphasizes that in the purposes section of the ordinance, the city articulated two distinct and constitutionally legitimate purposes for the ordinance (61 C4th at 444 (emphasis in original)):

1. Increasing the number of affordable housing units in the city in recognition of the insufficient number of existing affordable housing units in relation to the city's current and future needs.
2. Assuring that new affordable housing units that are constructed are distributed throughout the city as part of mixed-income developments in order to obtain the benefits that flow from economically diverse communities and avoid the problems that have historically been associated with isolated low-income housing.

The court finds those two stated objectives for the ordinance—to increase the community's stock of affordable housing and promote economically diverse residential developments—are "unquestionably constitutionally permitted purposes." 61 C4th at 463. The court also finds that the means the ordinance employs—imposing use restrictions in the form of price controls—is generally a constitutionally permissible means. (The court hypothesizes that the city could have pursued those purposes using different means, e.g., requiring all new residential developments to include a specified percentage of small units because these would likely be affordable.) Analogizing to the validity of price controls in the rental context that was approved by the United States Supreme Court in Pennell v City of San Jose (1988) 485 US 1, 108 S Ct 849, reported at 11 CEB RPLR 81 (Apr. 1988), the court reasons that the same principle of using price controls to respond to excessive prices applies to for-sale housing. 61 C4th at 464.

The court notes that price controls can violate the due process and takings clauses if they are "confiscatory," meaning that they deny a property owner a fair and reasonable return on its property. 61 C4th at 464. In this case, a facial chal-
lenge, there was no evidence that the application of the ordinance would be confiscatory, especially given the economic incentives and regulatory relief provided to developers who built affordable units on-site. Justice Chin’s concurrence speculates that an as-applied challenge to the San Jose ordinance could succeed if the ordinance required a developer to sell the affordable units below its cost, because the ordinance would then constitute an exaction rather than a reasonable price control. 61 C4th at 487.

Clarifying San Remo and Disapproving Patterson

After finding that CBIA’s legal theory—that the ordinance violates the unconstitutional conditions doctrine—lacked merit, the court considers CBIA’s contentions regarding the applicability of a certain passage in San Remo and the appellate court ruling in Patterson.

First, the court clarifies that neither of those cases referenced or relied on the unconstitutional conditions doctrine, as CBIA contended. Second, in response to CBIA’s argument that the passage in San Remo on which it relies should be interpreted to require San Jose to demonstrate that its inclusionary zoning requirements are reasonably related to the adverse impacts on the city’s affordable housing that are caused by or attributable to the proposed development, the court provides an extended exegesis clarifying the meaning of the passage in the context of that case.

The holding of San Remo was that San Francisco’s legislatively adopted affordable housing mitigation ordinance did not violate the California Constitution because it was reasonably related to mitigating the impact that the landowner’s proposed conversion of a residential hotel to a tourist hotel would have on the preservation of long-term rental housing in the city.

The court notes that CBIA’s selected passage from San Remo concerns a hypothetical posed by the plaintiff in that case, raising the specter that, in the absence of heightened scrutiny, cities could use restrictive zoning combined with purported mitigation fees to put their zoning up for sale and fill their coffers. The court corrected CBIA’s misconstruction of the passage and the case. First, the passage in context applies to permit conditions that require the payment of monetary fees, not to all permit conditions or those that regulate the use of property via price controls. Second, the passage applies only to development mitigation fees and not to price controls or other land use regulation that serves purposes unrelated to the impacts of proposed development.

The ordinance at issue in San Remo needed to be reasonably related to the deleterious effect of the developer’s proposal in that case because the sole purpose of the ordinance was to mitigate the effects of hotel conversions. The rule in San Remo is that an ordinance’s requirement must bear a reasonable relationship to the intended purpose of the ordinance at issue; San Remo did not announce a rule that subjected all land use requirements to heightened scrutiny. The court reaffirmed its prior distinction regarding judicial review requirements between general welfare legislation and mitigation requirements stated in Ehrlich v City of Culver City (1996) 12 C4th 854, reported at 19 CEB RPLR 68 (Mar. 1996).

Applying this understanding to the San Jose case, San Remo demands only that the ordinance’s requirement bear a reasonable relationship to its intended purposes. Despite mitigation being mentioned in the findings of the ordinance, San Jose’s ordinance was not primarily or purely a mitigation ordinance, but rather an ordinance with two distinct purposes (see “Inclusionary Zoning Is a Land Use Regulation Employing a Price Control,” above) that are intended to serve the broad general welfare. 61 C4th at 474.

The court rejects CBIA’s attempt to use the in lieu fee compliance option as a justification for applying a mitigation-type analysis to the entire ordinance. It pointedly notes that in lieu fees are typically included in inclusionary zoning ordinances precisely to “satisfy the demands of developers who seek the flexibility that an in lieu fee alternative offers” (61 C4th at 476) and that they are only paid as a choice by the developer. Since the in lieu fee is, by definition, in lieu of the developer fulfilling the 15 percent affordable housing building requirement, which is not a mitigation requirement, the in lieu fee is not a mitigation fee.

The court acknowledges that the Patterson court had applied the San Remo passage to an inclusionary requirement in the way that CBIA argued. However, the court concludes that Patterson was incorrect “to the extent it indicates that the conditions imposed by an inclusionary zoning ordinance are valid only if they are reasonably related to the need for affordable housing attributable to the projects to which the ordinance applies.” 61 C4th at 479. The Patterson court incorrectly interpreted the fee at issue in the development agreement as similar to the mitigation fee in San Remo, and thus applied San Remo’s test for the validity of that fee. But that fee, like San Jose’s inclusionary zoning ordinance, is intended to further the public purpose of increasing the city’s stock of affordable housing. Thus, the inclusionary requirements do not conflict with the San Remo passage, properly understood. The court does not express any view on the validity of the fee at issue in Patterson or the methodology employed to compute it. The court also criticizes the Patterson court for evaluating the fee in isolation from the city’s affordable housing condition as a whole, which offered the developer the option of building the affordable housing units. 61 C4th at 479.

Sterling Park Distinguished

In 2013, the California Supreme Court ruled that Palo Alto’s inclusionary zoning ordinance was an “exaction” under California’s Mitigation Fee Act for purposes of the Act’s statute of limitations when a developer challenged a fee. Sterling Park, L.P. v City of Palo Alto (2013) 57 C4th 1193 (Sterling Park). In that case, the court had specifically left open the question “whether forcing the developer to sell some units below market value, by itself, would constitute an exaction under section 66020.” 61 C4th at 482, citing Sterling Park, 57 C4th at 1207. CBIA argued that the court’s
finding an inclusionary ordinance to be an exaction in Sterling Park bolstered its argument in this case that San Jose's inclusionary zoning ordinance was an exaction, so that the San Remo standard of review would apply.

The court distinguished its Sterling Park decision on the law—it concerned solely procedural issues and did not address any substantive legal standard about the validity of inclusionary zoning. It noted that the decision did not mention San Remo or any other substantive legal standard. It also distinguished Sterling Park on the facts—it applied to Palo Alto's inclusionary zoning ordinance because that ordinance required developers to give the city a recordable option to purchase the affordable housing units to enforce their affordability restrictions.

Reflections on the Opinion

The primary holding in this case—that inclusionary zoning is a land use regulation—is consistent with Home Builders Ass'n v City of Napa (2001) 90 CA4th 188, reported at 24 CEB RPLR 234 (Aug. 2001), in which the court of appeal upheld a similar inclusionary zoning ordinance against numerous facial constitutional and statutory challenges as a land use regulation subject to rational basis review.

CBIA's attack on San Jose's ordinance is akin to prior developer attacks that seized on compliance alternatives (e.g., in lieu fees) or other aspects of inclusionary zoning ordinances (e.g., enforcement mechanisms) to frame them as "exactions" subject to heightened judicial scrutiny. (For a national review of legal challenges to inclusionary zoning, see Iglesias, Framing Inclusionary Zoning: Exploring the Legality of Local Inclusionary Zoning and its Potential to Meet Affordable Housing Needs, Zoning and Planning Law Report, Vol. 36, No. 4 (Apr. 2013).) California courts tend to view these challenges in the context of state housing laws regulating local governments' zoning authority to promote both affordable housing and residential integration, a context often ignored by developers and property rights advocates.

As the first state supreme court decision addressing inclusionary housing ordinances since the U.S. Supreme Court's 2013 decision in Koontz, this opinion may have national significance. California has been a leader in inclusionary zoning. At a minimum, other states' courts may look to this opinion for support.

Open Issues

While the court resolved many uncertainties in California's law of inclusionary zoning, several legal issues are still open. Because of fundamentally different perspectives on property rights and the exercise of government power between housing advocates and local governments (on the one hand) and some developers and property rights advocates (on the other), litigation on inclusionary zoning will continue.

First, since this case decided only a facial attack, there could be as-applied challenges. Most developers will probably reach a negotiated deal with localities. However, if such challenges are brought, they are likely to claim the price controls are confiscatory as applied. Cities should conduct economic feasibility studies before adopting an inclusionary zoning ordinance. In enforcing their ordinances, cities should be careful to consider the actual economic impact of an ordinance on a particular development.

Second, it is unresolved whether the Mitigation Fee Act's protest procedure and statute of limitations apply to all inclusionary zoning ordinances, or only those like Palo Alto's that require a conveyance by the developer to the city of a recognizable property interest. It is also unclear how the constraints imposed by the federal or state constitution on legislatively mandated mitigation fees compare with constraints imposed by the Mitigation Fee Act. In particular, Justice Werdegar's concurrence casts some doubt on CBIA's contention that San Remo required judicial scrutiny similar to Nollan/Dolan. Explicitly writing in dicta, Justice Werdegar's concurrence explains her understanding of the current status and meaning of the "reasonable relationship" standard in San Remo in light of Lingle v Chevron U.S.A. Inc. (2005) 544 US 528, 125 S Ct 2074, reported at 28 CEB RPLR 112 (July 2005). In her view, the "reasonable relationship" standard in San Remo is best understood as a due process test and, as such, is likely to be equivalent to the deferential level of judicial scrutiny applicable to regular land use regulations.

What's Next?

Cities with for-sale (as opposed to rental) inclusionary zoning may begin to enforce it after making any necessary tweaks that ensure the ordinance does not create an exaction. Those cities interested in enacting inclusionary zoning have a clear legal path to do so. Because the court deferred to San Jose's statement of the purpose of its ordinance (rather than accepting CBIA's characterization of it as a mitigation measure), cities adopting inclusionary zoning ordinances appear to have two options. They can enact an ordinance under their police power without a nexus study or they can adopt an affordable housing fee as a mitigation measure with a nexus study. Cities using nexus studies should expect legal challenges to the legal sufficiency of these studies, as CBIA has already commissioned at least one study on this issue.

The court appropriately left the Palmer decision undisturbed. Affordable housing advocates will no doubt try to extend the victory by seeking a legislative overturn of Palmer. Governor Brown vetoed an earlier bill in 2013 (AB 1229 (Atkins)) that would have exempted inclusionary zoning ordinances from the Costa-Hawkins Rental Housing Act (CC §§1954.50–1954.535). Part of the Governor's veto message explicitly sought direction from the California Supreme Court in the San Jose case. Housing advocates hope that with the court's clear and unqualified legal endorsement of inclusionary zoning, the Governor would now sign such a bill. The court may have indicated its support for such a revision when it commented that "the California Legislature is unquestionably aware" of local inclusionary zoning ordi-
nances and that "existing state legislation is neither inconsis-
tent with nor intended to preempt these local measures." 61
CA4th at 446. Importantly, the other part of the Governor's
veto message expressed his skepticism from a policy per-
spective of the value of inclusionary zoning for cities like
Oakland (where he had been mayor). Since the Palmer fix
would likely only seek to allow cities that want to enact
rental inclusionary zoning to do so and not force any city to
do so, the Governor may be more likely to defer to the policy
choices of local elected officials.

CBIA may file a petition for certiorari with the U.S.
Supreme Court. The Court may be interested in clarifying
the scope of the unconstitutional conditions doctrine
recently articulated in Koontz (a case brought by the Pacific
Legal Foundation, which represented CBIA before the Cali-
ifornia Supreme Court in the San Jose case). CBIA may
believe that the California Supreme Court has misinterpreted
Koontz. Or it could petition the high court to answer an issue
it left open in Koontz—whether the unconstitutional condi-
tions doctrine applies to legislatively enacted regulations
(such as San Jose's inclusionary zoning ordinance) rather
than only to ad hoc demands in the permitting context.

CROSS-REFERENCES: For discussion of inclusionary
housing ordinances, see California Land Use Practice §6.2
(Cal CEB) and Condemnation Practice in California §15.24
(3d ed Cal CEB).

MIDCOURSE CORRECTIONS

Rethinking Rescission
Roger Bernhardt

Wong v Stoler

Wong v Stoler (2015) 237 CA4th 1375, reported at p 133,
is a fascinating decision to read and to draw predictions
from.

The basic facts are that the purchasers of a hillside resi-
dence in San Carlos rescinded their completed contract
because of misstatements made by the sellers to the effect
that the property was served by a public sewer, when in fact
the system was privately owned by the 13 residents of the
area, who all had to share its maintenance costs. The trial
court found that the sellers' statements were negligent mis-
representations, but it declined to order rescission because of
the complications involved in unwinding the deal. Instead, it
ordered the sellers to indemnify the purchasers for their
sewer maintenance costs over the next decade.

The complications that deterred the trial court from grant-
ing recessionary relief included that this contract had been
completed in 2008. In the seven years since then, the pur-
chasers had spent $300,000 on remodeling the property,
including rebuilding the garage and the kitchen and remov-
ing much of the landscaping, before giving up attempting to
get their neighbors to take the steps the city was requiring
about the sewer. Meanwhile, the sellers had spent $100,000
on improving their new house. Would you want to be the
judge who had to untangle a mess like that?

But the court of appeal thought the trial court did not have
discretion to refuse to unwind the transaction because a fail-
ure to do so would deny the purchasers the full relief that our
statutes demand in the case of a successful rescission.
Because the trial court had found the sellers to be guilty of
negligent misrepresentation, and since that is a species of
fraud, the purchasers were entitled to rescind and be
awarded "complete relief" under CC §1692, which the trial
court's substitute indemnity order did not provide.

What Does This All Mean?

Defrauded purchasers (with whom I include for conve-
nience those harmed by negligent misrepresentation as well
as by lies) have always had a choice of two remedies: They
could affirm the contract and sue for damages or they could
rescind the contract and seek restitution. An action for dam-
ages is limited in most cases, by CC §3343, to the difference
between the price paid ("the actual value of that with which
the defrauded person parted") and the value of the property
purchased ("the actual value of that which he received").
This is not a very healthy measure. For instance, if the seller
says that the property has amenities that make it worth $1
million—which would be correct if true—but it has no such
amenities and is worth only $750,000, the purchasers have
no §3343 damages if they only paid $750,000 for the prop-
erty (thinking they were getting a bargain). Section 3343
explicitly asserts that a defrauded person cannot recover the
difference between the "value of property as represented
and the actual value thereof." Although the statute sometimes
permits a defrauded purchaser to recover lost profits, that
protection does not extend to residential buyers who
intended to live there. Thus, purchasers who were deceived
but nevertheless got what they paid for (rather than what they
misbelieved it was worth) have no recoverable damages and
are generally forced to choose rescission instead of suing at
law.

Rescission doesn't entitle a party to benefit-of-the-
bargain damages either, but it does let swindled purchasers
get their money back. If a national economic bubble has
burst, so that the property they now own is worth a lot less
than what they originally paid for it (the Wongs paid $2.35
million for the property in 2008), rescission may be the
smarter choice (although with prices now surging again, the
Stolers may be the ones who make a profit in this particular
case).

Rescission has its own requirements, so counsel for plain-
tiffs must first make sure that this remedy is available. Civil
Code §1689b requires a showing of mistake, duress, men-
ace, fraud, undue influence, failure of consideration, or ille-
gality, but the fraud requirement is probably no different
from the fraud needed in a damage action under CC §3343.