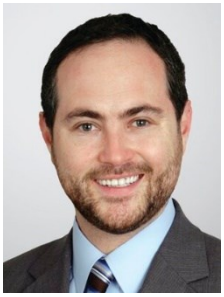
A Deep Dive Into High Court's Permit Fee Ruling

By **David Robinson and Daniel Golub** (April 26, 2024)

David Robinson



Daniel Golub

In Sheetz v. County of El Dorado, California, a unanimous decision authored by Justice Amy Coney Barrett, the U.S. Supreme Court on April 12 set the stage for widespread lawsuits contesting the constitutionality of the many billions of dollars in impact fees developers are forced to pay annually to get construction permits.

The court ruled that the takings clause enshrined in the Fifth Amendment of the U.S. Constitution applies equally to legislative and administratively imposed fees, thus both are subject to some level of heightened scrutiny under what the court previously dubbed the "unconstitutional conditions doctrine."

In three concurring opinions, however, five of the nine justices hastened to add that they do not necessarily agree on what this means for developers and real estate investors going forward.

Sheetz in a Nutshell

As Sheetz v. County of El Dorado[1] confirms, the essence of the Fifth Amendment's takings clause is if "the government wants to take private property to build roads, courthouses, or other public projects, it must compensate the owner at fair market value."[2] This saves "individual property owners from bearing 'public burdens which, in all fairness and justice, should be borne by the public as a whole.'"[3]

In addition to the two traditional types of Fifth Amendment takings — physical and regulatory[4] — the court recognized in 2005 in Lingle v. Chevron USA Inc. that land-use exactions can also amount to takings.[5] A land-use exaction occurs whenever the government demands a project applicant give up property or money before receiving a permit.

Tailoring a rule that balances the government's legitimate police power to offset the costs of a particular development's impact on public resources, e.g, by imposing a fee to widen a road or build a new fire station needed to service the new development, while at the same prohibiting "out-and-out plan[s] of extortion," can be "complicated," per Sheetz.[6]

What is "extortion"? Per Sheetz, it is "when the government withholds or conditions a building permit for reasons unrelated to its land-use interests."[7]

What is "unrelated"? As explained below, it is the very question that previously led the court to create the "unconstitutional conditions doctrine" established in 1987 in Nollan v. California Coastal Commission and in 1994 in Dolan v. City of Tigard — also known as the Nollan/Dolan test.[8]

How does Nollan/Dolan apply to the likely wave of impact fee challenges to come? This is the very question Sheetz has now instructed the California courts to decide in the first instance.

What guidance does Sheetz offer lower courts, governmental agencies and the real estate community in general to predict the outcome of this high-stakes debate? As explained below, a mixed bag.

Before delving into the contents of this mixed bag, however, it is important to understand how and why a case contesting a $23,420 fee, after eight years of hard-fought litigation and the expenditure of no doubt many times that amount, made its way all the way to the U.S. Supreme Court.

It is also important to understand that even though Sheetz marks a sea change in California law, practically speaking, the battle is far from over.

How Sheetz Came To Be

Because of its increased population growth, in July 2004, El Dorado County — a largely rural area east of California's capital city that extends to the picturesque shores of Lake Tahoe — adopted a new general plan, the "2004 El Dorado County General Plan: A Plan for Managed Growth and Open Roads; A Plan for Quality Neighborhoods and Traffic Relief."

In August 2006, the county amended this general plan to include a traffic impact mitigation, or TIM, fee program to finance new roads and the widening of existing roads. The TIM program required any new development to pay a fee to construct new roads and widen existing roads without regard to the costs specifically attributable to a particular project. Put another way, under the TIM program, the county does not make "individualized determinations"; rather, it applies a preset formula based on a project's location and type.

In July 2016, George Sheetz applied for a building permit to construct a 1,854-square-foot prefabricated single-family home on his property in Placerville, a small town in the Sierra Nevada foothills famous for its role in the California gold rush. He explained that he planned to raise his grandson there. The county agreed to issue the permit on the condition that Sheetz pay a $23,420 TIM fee. This fee consisted of $2,260 for improvements to Highway 50[9] and $21,160 for local roads. After Sheetz paid the fee, he received the necessary permit in August 2016.

In December 2016, Sheetz sent the county a letter protesting the TIM fee under California's Mitigation Fee Act[10] and other grounds. Thereafter, he sent more letters, all requesting a refund. The county never responded.

In June 2017, Sheetz sued. He challenged the validity of the TIM program under both California and federal law, seeking a writ of mandate, i.e., a refund, along with declaratory and injunctive relief.

For his California claims, Sheetz alleged the fee violated California's Mitigation Fee Act, a statute requiring a "reasonable relationship" between 1) the amount of the fee and the cost of the public facilities, i.e., road improvements, specifically attributable to his development project; and 2) the traffic impacts caused by his development project and the need for road improvements within the county.

Sheetz further alleged the fee violated the Mitigation Fee Act because it included costs attributable to preexisting deficiencies in the county's "traffic infrastructure." Finally, he alleged the fee was invalid under California's Administrative Procedures Act[11] because the county's decision to impose the fee was not supported by legally sufficient findings, and its findings were not supported by legally sufficient evidence.

For his federal claims, Sheetz asserted the fee violated the takings clause, specifically the above-mentioned unconstitutional conditions doctrine established in Nollan/Dolan.

His lawsuit never got off the ground. The El Dorado Superior Court summarily dismissed it, ruling that none of his claims as pled had colorable merit. In a published decision, the California Court of Appeal, Third Appellate District, agreed.[12] The California Supreme Court refused to consider the matter.

The U.S. Supreme Court, however, agreed to review one issue and one issue alone: whether Nollan/Dolan applies to a legislatively imposed permitting fee.

Why the U.S. Supreme Court Stepped In

As Sheetz confirms, Nollan/Dolan instructs permit conditions must have both an "essential nexus" and "rough proportionality" to the government's avowed land-use interest. The nexus requirement ensures the government is acting to further that interest as opposed to abusing "its permitting monopoly" to commit extortion. Proportionality ensures a landowner is not being asked to give up more than needed to mitigate harms resulting from a proposed new development.

None of this mattered to the California courts, however, as the California Supreme Court had previously ruled in San Remo Hotel v. San Francisco that Nollan and Dolan applied only to development fees imposed by administrative — as opposed to elected legislative — officials on "an individual and discretionary basis."[13]

In so doing, California's high court reasoned in the 2002 San Remo case that whereas a "city council that charged extortionate fees ... would likely face widespread and well-financed opposition at the next election[, a]d hoc individual monetary exactions deserve special judicial scrutiny mainly because ... they are more likely to escape such political controls."[14]

According to all nine U.S. Supreme Court justices on April 12, California was wrong.

Per Sheetz, "there is no basis for affording property rights less protection in the hands of legislators than administrators. The Taking Clause applies equally to both — which means that it prohibits legislatures and agencies alike from imposing unconstitutional conditions on land-use permits."[15]

This is the principle holding and lesson of Sheetz.

What Sheetz Does Not Decide

On the one hand, Sheetz appears to say the Nollan/Dolan heightened scrutiny test applies to all takings challenges to impact fees.

On the other, the decision warns: "We do not address the parties' other disputes over the validity of the traffic impact fee, including whether a permit condition imposed on a class of properties must be tailored with the same degree of specificity as a permit condition that targets a particular development."[16]

In this regard, the concurrence written by Justice Brett Kavanaugh, joined by Justices Elena Kagan and Ketanji Brown Jackson, suggests in the future these three justices might be

inclined to rule that "reasonable formulas or schedules" that assess the impact of whole "classes of development rather than the impact of specific parcels of property" suffice to pass constitutional muster.[17] But what these justices mean by "reasonable formulas or schedules" remains to be seen.

Justice Neil Gorsuch, however, clearly thinks such a ruling would be a mistake. Explaining that both Dollan and Nolan involved takings resulting from the implementation of comprehensive governmental programs or land-use plans applied to particular types or classes of development, his concurrence reasons that

> the Nollan/Dolan test asks whether the condition in question bears an 'essential nexus' to the government's land-use interest and has 'rough proportionality' to a property's impact on that interest. ... Nothing about that test depends on whether the government imposes the challenged condition on a large class of properties or a single tract or something in between.[18]

Then there is Justice Sonia Sotomayor's concurrence, joined by Justice Jackson. It says before Nollan/Dolan even comes into play, one must ask whether the government could "constitutionally order[] the person asserting the claim to do what it attempt[s] to pressure that person into doing."[19]

As this concurrence fails to say what other power the government might assert to impose such a fee, the possibility of the government's power to tax comes to mind. Indeed, as the reader will recall, this was the ground on which Justice John Roberts, writing for a divided court, upheld the Affordable Care Act in National Federation of Independent Business v. Sebelius.[20]

However, insofar as various state and local laws prohibit the imposition of taxes without voter consent,[21] it remains unclear what effect, if any, this concurrence will have on future governmental actions and ensuing litigation.

What Is Clear

- California's rule of applying the Nollan/Dolan heightened scrutiny test only to ad hoc, discretionary fees is now null and void.
- Based on the writings of five of nine justices, to pass constitutional muster, a fee must be "reasonable" as defined by Nollan/Dolan.
- According to at least one justice, to be reasonable, each time there must be an individualized determination of whether the fee bears an essential nexus to the government's land-use interest and has rough proportionality to a particular property's impact on that interest.
- According to three justices, it might be possible for the government to satisfy Nollan/Dolan by devising "reasonable formulas or schedules that assess the impact of classes of development rather than [assess] the impact of specific parcels of property."
- Finally, according to two justices, if the government can come up with another basis to impose the fee, it can avoid Nollan/Dolan reasonableness scrutiny altogether.

That's quite a mixed bag for California and other courts to wade through in the likely

tsunami of lawsuits to come.

What's Next?

Plainly, the stage is now set for more lawsuits challenging what Justice Kavanaugh aptly describes as "the common government practice" of imposing impact fees. This has long been a source of contention, as such fees — often amounting to hundreds of thousands of dollars per residential unit — increase the cost of already limited and expensive housing.

Given the razor-thin — or recently upside-down — home-building margins, particularly in California, such fees serve to deter the production of critically needed new housing.[22] They also create a three-fold hidden cost for homebuyers: They 1) add to the initial sales price, 2) increase interest paid over the life of a purchase money mortgage, and 3) increase the cost basis, thus they permanently increase the assessed property taxes.

The question has also been asked: Why are only a few — in this case, developers, new homebuyers or renters of newly built apartments — required to pay for public improvements and services meant to benefit the public at large? Is this fair?

On the other hand, particularly in California where the state legislature controls the lion's share of the tax revenue and Proposition 13 caps increases on real estate taxes, local governments understandably have been forced to get creative in finding alternative revenue sources.

This has led to their increased reliance on aggressively imposed impact fees. Moreover, even though the California Mitigation Fee Act prohibits fees to fix preexisting infrastructure deficiencies, the question becomes, what is "preexisting"?

In an amicus brief, the city and county of San Francisco argued:

> [l]ike many cities, towns, and counties across the country ... [it] must address a growing need for public recreational and open space, childcare, improved streets and roads, transit, library, police, fire, and other community facilities created by new development projects. This need ... stems from projects containing critically needed housing ... In doing so, jurisdictions like San Francisco have exercised their long-established police power to enact land use ordinances of general application including development impact fees for new projects.

The same brief suggests the inspiration for Justice Sotomayor's concurrence insofar as San Francisco argues such fees "would not constitute a taking if imposed directly on the property owner."

But even if local governments are not allowed to balance their flagging budgets on the backs of developers, new homebuyers and renters, will they get creative and try to raise the money elsewhere?

One possibility is an increased reliance on fees imposed as purported "environmental mitigation" under the aegis of California's Environmental Quality Act.[23] This tactic seems problematic, however, as a little-known CEQA provision incorporates the Nollan/Dolan test by reference as a limitation on a local agency's authority to impose environmental mitigation.[24]

In the meantime, the real estate industry as a whole can expect a spike in the demand for

"nexus" and "proportionality" experts and studies. The pressure on local governments to justify their fees will also likely strain existing developer/municipal relationships.

And, if local budgets are further taxed as a result of either a fall-off in impact fee revenues or the need to defend a series of new lawsuits, there may even need to be a wholesale reexamination of the way property tax revenues are allocated among the state and local governments.

Finally, the courts have already seen litigants in other contexts rely on Sheetz, e.g., to support the argument now pending in several courts that the federal government's use of the Inflation Reduction Act to threaten to withhold coverage under Medicare and Medicaid for all of a pharmaceutical manufacturer's products, the government is unconstitutionally leveraging its monopoly in the prescription drug market to coerce manufacturers to give up their property.[25]

David Robinson and Daniel Golub are partners at Holland & Knight LLP.

[1] Sheetz v. County of El Dorado, 2024 U.S. Lexis 1574, *7 (April 12, 2024) (Sheetz).

[2] Id. at *7.

[3] Armstrong v. United States, 364 U. S. 40, 49, 80 S. Ct. 1563, 4 L. Ed. 2d 1554 (1960).

[4] Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency, 535 U.S. 302, 321, 152 L. Ed. 2d 517, 122 S. Ct. 1465 (2002).

[5] Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 536, 161 L. Ed. 2d 876, 125 S. Ct. 2074 (2005).

[6] Sheetz, 2024 U.S. Lexis 1574, *7. Extortion is also described in Sheetz as "leveraging [the government's] permitting monopoly to exact private property without paying for it." 2024 U.S. Lexis 1574, *12.

[7] 2024 U.S. Lexis 1574, *11.

[8] Nollan v. California Coastal Comm'n., 483 U.S. 825, 97 L. Ed. 2d 677, 107 S. Ct. 3141 (1987) and Dolan v. City of Tigard, 512 U.S. 374, 129 L. Ed. 2d 304, 114 S. Ct. 2309 (1994).

[9] Highway 50 is one of the main routes to and from Lake Tahoe from California's Central (San Joaquin) Valley.

[10] California Gov't Code § 66000, et seq.

[11] California Gov. Code, § 11340 et seq.

[12] Sheetz v. County of El Dorado, 84 Cal. App. 5th 394, 300 Cal. Rptr. 3d 308 (2022).

[13] Sheetz v. County of El Dorado, 84 Cal. App. 5th 394, 409, 300 Cal. Rptr. 3d 308 (2022), citing San Remo Hotel v. City and County of San Francisco, 27 Cal.4th 643, 666-670, 117 Cal. Rptr. 2d 269, 41 P.3d 87 (2002) (San Remo Hotel); Ehrlich v. City of Culver City, 12 Cal.4th 854, 859-860, 866–867, 876, 869, 881, 50 Cal. Rptr. 2d 242, 911 P.2d 429 (1996) (Ehrlich) (plur. opn. of Arabian, J.) [heightened scrutiny under the Nollan/Dolan test appropriate when monetary exactions are imposed ad hoc on an individual basis due to greater risk of arbitrariness and government abuse in such situations].

[14] San Remo Hotel, 27 Cal. 4th at 671.

[15] 2024 U.S. Lexis 1574, *17.

[16] 2024 U.S. Lexis 1574, *18 (italics added).

[17] Id. at *24.

[18] 2024 U.S. Lexis 1574, *20-21 (italics added).

[19] Id. at *19.

[20] 567 U.S. 519, 519, 132 S. Ct. 2566, 2571 (2012).

[21] E.g., in California Proposition 218 and Rev. & Tax Code § 7285.9 impose such limitations. Proposition 218 states "[n]o local government may impose, extend, or increase any general tax unless and until that tax is submitted to the electorate and approved by a majority vote…." (Cal. Const., art. XIII C, § 2, subd. (b)).

[22] See University of California, Berkeley's Terner Center for Housing Innovation, "Making It Pencil: the Math Behind Housing Development – 2023 Update." https://ternercenter.berkeley.edu/research-and-policy/making-it-pencil-2023/.

[23] Pub. Res. Code § 21000, et seq.

[24] 14 California Code of Regs., § 15041(a).

[25] See, Bristol Myers Squibb Company v. Becerra, et al., United States Dist. Ct. for the Dist. of New Jersey, Civil Action No. 23-3335 (ZNQ)(JBD); Merck & Co., Inc., et al. v. Becerra, et al., United States Dist. Ct. for the Dist. of Columbia, Civil Action No. 1:23-01615 (CKK).