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In-Lieu Fees Must Be Refunded if City Has Not Timely Made Five-Year Findings Under MFA, Sixth District Rules

Must in-lieu fees paid by a developer as a condition of project approval be repaid by the city if it has not timely adopted the five-year findings required by the Mitigation Fee Act? Yes, the Sixth District Court of Appeal ruled last week in *Hamilton and High, LLC v. City of Palo Alto* (March 20, 2023 No. H049425) __ Cal.App.5th __, 2023 WL 2570589.

The Sixth District held that the developers were entitled to refunds of in-lieu parking fees, even though they had chosen to pay the in-lieu fees rather than provide parking for their project at the levels required by local regulation, and despite the fact that the city had belatedly adopted the requisite findings.

The Court also rejected the city's arguments that the developers' cause of action for refunds did not accrue until the city had denied a demand for refund. Since the developers had filed suit only three months after the city denied the refund demand, the court did not resolve whether a one-year statute of limitations applies to such refund claims, as the Third District has ruled, or a three- or four-year statute of limitations applies, as the developers asserted.

Cities and other agencies that collect fees to mitigate the impacts of development – including in-lieu fees paid by developers rather than developing per code requirements – should take extra precautions to ensure that they timely comply with the findings requirements of the Mitigation Fee Act, or they risk substantial liability for refunds and loss of moneys to provide necessary public facilities.

Our attorneys at Burke – including Megan A. Burke and Kevin D. Siegel, who authored this summary – are well-versed with these issues and can help with compliance and litigation.

Read on for more about the Mitigation Fee Act and this important new decision.

I. Background re Mitigation Fee Act Five-Year Reporting Requirement

The Mitigation Fee Act ("MFA") (Gov. Code § 60000 *et seq*.) governs local agencies' adoption, imposition, collection, accounting, and

expenditure of fees that mitigate the impacts of development, including to fund the costs of the public infrastructure necessary to serve new growth. Government Code section 66001(c) requires that local agencies deposit impact fee revenues in a segregated account, and section 66006(b) requires agencies to issue annual reports detailing the fee revenues that they collected and the projects on which the revenues were expended.

Beginning the fifth fiscal year following the agencies' first deposit of fee revenues into the segregated account, and every five years thereafter, section 66001(d) requires the agency to make findings regarding the portion of the fee revenues that remain unexpended. These findings include (1) identifying the purpose to which the fee is to be put; (2) demonstrating a reasonable relationship between the fee and the purpose for which it is charged; (3) identifying all sources and amounts of funding anticipated to complete financing in incomplete improvements; and (4) designating the approximate dates on which the funding is expected to be deposited in the appropriate account or fund. These five-year findings must be made and released to the public within 180 days after the last day of the agency's fiscal year and must be reviewed at the agency's next regularly scheduled public meeting, but not less than 15 days after the information is made available to the public.

If an agency fails to make the five-year findings required by section 66001(d), the MFA states that the "agency shall refund the moneys in the account or fund." Subdivision (e) of section 66001 provides the agency legislative discretion to choose from specified options as to how to provide refunds for failure to make the five-year findings, e.g., by payment to current owners of record, or by suspending fees.

The MFA's five-year reporting requirements apply both to fees imposed by legislation and on an ad-hoc basis "in connection with approval of a development project for the purpose of defraying all or a portion of the cost of public facilities related to the development project." (Gov. Code § 66000(b).) Although this broad definition encompasses most development impact fees, the MFA exempts certain fees from the five-year reporting requirement: Quimby Act fees, fees collected pursuant to a development agreement, and permitting fees.

II. The Sixth District Decision

A. Factual Background

Palo Alto adopted detailed parking regulations as part of its Commercial Downtown zoning district. These regulations included the option to pay an in-lieu parking fee, rather than providing new parking spaces. The parking fees were to be used to construct new parking facilities to meet the increased demand for public parking caused by

new nonresidential developments. Palo Alto's Code established a parking fund, and all in-lieu fees were deposited therein.

Historically, Palo Alto treated the in-lieu parking fee as being subject to the MFA's reporting requirements and made the five-year findings in 2009 and 2014. However, in 2019, Palo Alto did not include the parking in-lieu fees in its five-year findings report.

For years, Palo Alto had planned to use the in-lieu fee revenues to construct a downtown parking garage. But in 2019, the City Council changed course, directing staff to develop a parking management strategy rather than move forward to develop a parking garage.

Meanwhile, in December 2013, plaintiffs paid $972,000 in parking in-lieu fees to Palo Alto in connection with their development project. In January 2020, plaintiffs requested that the City refund the in-lieu fees it had paid, with interest, on the grounds that the fees had been paid more than five years before and the City had "not used those fees for parking facilities nor provided the" required five-year findings. The City denied the refund claim in February 2020, and plaintiffs filed a petition for writ of mandate seeking a refund of plaintiffs' previously paid in-lieu fees and injunctive and declaratory relief ruling that the MFA applies to such in-lieu fees.

B. Analysis

The Superior Court ruled for Palo Alto. The Court of Appeal reversed and directed judgment to be entered in favor of the plaintiffs.

First, the Court of Appeal rejected Palo Alto's argument that the in-lieu parking fees were not subject to the MFA because the plaintiffs had voluntarily paid them rather than provide parking for their project per the City's parking requirements. The Court distinguished case law that holds affordable housing in-lieu fees need not be reasonably related to a project's impact on affordable housing – *California Building Industry Assn. v. City of San Jose* (2015) 61 Cal.4th 435 and *616 Croft Ave., LLC v. City of West Hollywood* (2016) 3 Cal.App.5th 621. The Sixth District reasoned that the purpose of the affordable housing in-lieu fees at issue in those cases was to "combat the overall lack of affordable housing," not to "defray the cost of increased demand" on public facilities caused by new development. By contrast, the Court explained, the purpose of the parking in-lieu fee was to fund parking facilities related to new development. Thus, the Court concluded that the fees were subject to the MFA's reporting requirements.

Second, the Court held that plaintiffs' action for refund, filed in May 2020, was not time-barred, despite the fact that plaintiffs paid their parking in-lieu fees in December 2013 and the City failed to make the five-year findings in January 2019. According to the Court, plaintiffs'

cause of action accrued, at the earliest, when Palo Alto denied their request for refund in February 2020. As the suit was filed a mere three months later, the Court left open whether a three- or four-year statute of limitations would apply (failure to meet a statutory duty or catch-all statute of limitations, respectively), or a one-year statute of limitations would apply (for penalty or forfeiture, as the Third District held in *County of El Dorado v. Superior Court* (2019) 42 Cal.App.5th 620). Further, the Court implicitly rejected the Third District's reasoning that a refund claim accrues upon the agency's failure to make the five-year findings, rather than when agency rejects the plaintiff's demand for a refund, which expands the window of potential liability.

As to the merits, the Court rejected the City's argument that it was only required to make findings regarding the use of revenues that had been in the account for more than five years. Instead, the Court ruled that, if at the five-year mark the fee account contains a positive balance, the agency must make findings on "all unexpended fees in the account or fund, irrespective of the date at which the fees were deposited."

Next, the Court determined that Palo Alto's belated findings, made one year after the statutory deadline, were not sufficient to cure its initial failure. Since Government Code section 66001(d)(2) expressly states that the findings must be made at the same time as the annual findings – within 180 days of the end of an agency's fiscal year – Palo Alto could not escape the unequivocal consequence of refund liability.

Finally, the Court rejected Palo Alto's argument that any error was harmless, and thus no refund was warranted. The Court reasoned that to deem the error harmless would frustrate the purpose of the statutory requirement to provide refunds of fees if the five-year findings requirement was not satisfied.

While the Court recognized that "the prescribed remedy for an agency that has not made the required five-year findings to 'refund the moneys in the account or fund' (§ 66001(d)(2)) might be viewed as severe where the error or omission in making the required findings could be perceived as slight or emendable," it determined that such speculation about preferred policy outcomes was beyond its judiciary role. The Court then directed the trial court to enter a new judgment (1) granting the mandate petition and directing Palo Alto to comply with the refund requirement in section 66001(d)(2); and (2) granting the declaratory and injunctive relief cause of action that the MFA applies to such fees.

C. Implications

This Sixth District decision expands the risk of refund litigation for local agencies that impose development impact fees, including by

extending the scope to in-lieu fees and by suggesting that the cause of action for refund might not accrue until a refund demand is denied, rather than at the time an agency fails to make the five-year findings. Agencies should pay special attention to their five-year findings reports to ensure that the findings address all potential impact fees, including in-lieu fees. Agencies should be thoughtful of the deadline for making the five-year findings for each of the fees it charges and should consider making the findings every year to avoid potential error or noncompliance.

The fact that Palo Alto was continuing to collect parking in-lieu fees, despite the fact that the City Council was no longer actively pursuing the downtown parking garage project, could have also played a role in this decision. Accordingly, it is good practice to maintain clear and definitive capital improvement plans for all impact fee revenues and to diligently pursue those plans to completion.

Finally, note that the decision has no effect on public agencies' authority to provide developers the option paying in-lieu fees to rather than developing the project per code requirements (e.g., in-lieu fees for the city to develop parking facilities rather than the developing providing the number of parking spaces required by code). But public agencies should have heightened awareness that they may need to refund in-lieu fees if the agency does not thereafter comply with the MFA's requirements.

III. Conclusion

Hamilton and High is an important case with broad implications for impact fees and capital infrastructure planning across the state. Our attorneys at Burke can help avoid or limit or liability, including by reviewing existing findings, helping to craft future findings, and handling litigation.