A Challenging Process Outlined

By Brian Semel

Abstract

The development process is defined by variables. A successful developer identifies, monitors, understands, and attempts to control these variables. Most development projects require the developer to be prepared to negotiate with any number of parties, and much of the time, the tie-up or acquisition of the property is only the first step in a long process. For many projects, the discretionary approval process at the local level, commonly called entitlement, is the major consumer of time and resources. It is through this very process, however, that value is created. Gaining an understanding of the legal aspects of land-use regulation in general—and entitlement in particular—can help developers effectively identify and manage risk. This paper provides an overview of the procedural and legal underpinnings of the entitlement process in order to illustrate the risks involved. Several techniques for creating value and mitigating risk, as applied through the approvals process, are also discussed.

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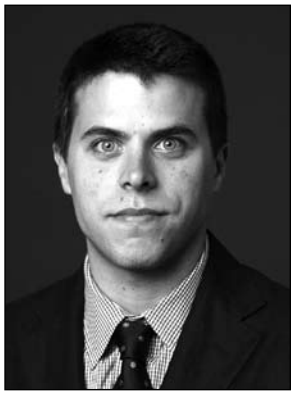
Introduction

Entitlement includes both formal and informal approvals. With some research, the formal approval process is easily identifiable within a given local government and is codified as law, outlined in the zoning ordinance and subdivision regulations. The informal side of this process, as demonstrated in the hypothetical scenario below, is often much more variable. Essentially, the whole process is about the parties, both the developer and local government, evaluating and mitigating risk. For the developer, who stands to incur significant capital outlays during the approvals process, it is a matter of assessing the probability of receiving the required approvals, and making decisions based on that probabilistic outcome. While the developer is monitoring many conditions simultaneously, he or she is primarily concerned with whether the overarching vision will be approved. The local government for its part has other major considerations, and must make a determination as to how the project will affect the health, safety, and welfare of the public, tax revenues, municipal services, and economic growth both at the time of construction and well into the future.

Land-Use Law and Approvals



Land-use regulation has effectively framed individual property rights into a larger communal context. Through land-use regulation, and zoning in particular, communities endeavor to protect citizen welfare and plan for the future. That future, and health of their community, is largely based on a municipality's ability to effectively plan and regulate land-use activities. The principal mechanism of prospective planning is a comprehensive plan, which may be more or less formal depending on the state. The comprehensive plan is essentially a road map for managing land use and growth within the community. The power to create a comprehensive plan is delegated to local governments by the state in the form of state-specific zoning enabling acts. This enabling legislation provides guidelines for local governments, and their administrative agencies, to address land use concerns independent of any state agency. Once a comprehensive plan is adopted, the municipal government is obliged to make use of the document by examining whether proposed land uses are in accordance with the plan.

Granting local governments this sort of latitude in land-use planning results in widely variable entitlement processes. The agency that advises the local government's legislative body in adopting land-use regulation is typically known as the planning board. Assisted by the support of the city planning department, the planning board is an appointed group of citizens charged with evaluating and approving proposed development projects. Sometimes local governments require board members to have professional experience in architecture, planning, and/or development however, in many smaller communities, these people have no professional real estate related experience. In addition to granting approvals, the board is involved in crafting and amending the comprehensive plan and the zoning ordinance, which are then adopted by the City Council. In its ongoing function, the board often has final say on approving or denying special and conditional use permits and conducting site plan review.

Another important administrative body is the Zoning Board of Appeals (ZBA). While the planning board supports legislative decisions regarding zoning and makes basic planning decisions related to prospective developments, the ZBA has administrative authority to grant zoning exceptions on a case-by-case basis. Although as-of-right developments do exist, highest and best use analyses often suggest using a parcel of land in a manner for which is not zoned. As a result, developers must interact with the local governments legislative and/or administrative bodies.

In addition to the permitting and rezoning process, many local governments require site plan review for large or complex projects that will likely have substantial economic, social, and/or land-use impacts on the community. In these cases, a developer seeking to improve property generally submits a preliminary site plan to the local planning department. The planning department acts as an informal advisor, suggesting changes that align the project with community needs and desires. The developer then formally submits the plan for review by the planning board. A public hearing is held to give adjacent landowners the opportunity to express their concerns with the proposal. The board then votes on the issue in a manner consistent with public interest and the comprehensive plan. If the board's vote is affirmative, the developer has the required discretionary approval and may begin obtaining building permits and improving the land.

Of course, the above scenario makes plan approval sound like an expedient, relatively uncomplicated affair. Rarely, however, is the process so simple. Citizens, community groups, politicians and other government agencies, often have an interest in development proposals. For very controversial projects, public hearings may be large and complex affairs, even to the point of involving lawyers, expert witnesses, and sworn testimony. If that is the case, it is easy to see that the developer stands to spend a lot of money upfront, without any guarantee of an ultimate approval.

Moreover, the approval process does not begin and end with the planning board. If, for example, a property contains wetlands, the Army Corps of Engineers may have to review and approve plans. If the property is in a historic district, the developer may need approval from a historic preservation commission. Approvals are often subject to conditions that may be quite onerous. Perhaps the developer can improve only a portion of the plan, must reduce density, use more expensive materials, and/or conduct more extensive studies. Sometimes, the developer has to start over or abandon the project. As any veteran developer can tell you, it is critical to learn about these various agencies because cost, time, and energy are expended satisfying these issues.

It is also well known that entitlement can be a protracted affair. While courts have carved out, and clarified, many issues regarding land-use in the last 25 years, the entitlement process has gotten longer, and in some cases less predictable. Thus, on a relative basis, it is arguable that a developer incurs *more* risk today than in times past. Developers have improved their own methods of mitigating this risk by increasingly engaging in a variety of measures like joint ventures and public-private partnerships, to name a few. Still, the developer may have to commit significant capital to the entitlement process. Given the issues outlined in this article, developers have to be extremely well-prepared for entitlement.

Tools and Techniques

Preparing for the entitlement process requires an understanding of the risks involved. Knowing the basic regulatory structure, as outlined above, is important in order to navigate the process and assess which bodies have approval power. The developer should also work to understand processes of amending a zoning ordinance, special and conditional uses, variances, vested rights, development agreements, exactions and impact fees. While these concepts may not always apply to a particular project, developers must be cognizant of their potential impacts. Before committing resources to a new project, developers should research the local government's approval process, seeking procedural and political knowledge.

"Amendment" refers to a zoning amendment, the most common change pursued by developers. In theory, this zoning change "is a legislative act for the good of the community, regardless of the advantages or disadvantages to the owner and neighbors of the property affected by the amendment."[1] If, for example, a developer wants to pursue a commercial project in a residential zone he may seek a zoning amendment. Typically this means filing an application and going through an intense legislative process. Nearby residents often oppose amendments for many reasons, including protection of their own property values, and potentially affected parties have the opportunity to speak for or against the amendment at designated public hearings. A common argument from residents is that amending the zoning ordinance for a unique parcel constitutes spot zoning or "the singling out by a zoning amendment of a small parcel of land that permits the owner to use it in a manner inconsistent with the permissible uses in the area" and is not in accordance with the comprehensive plan.[2]

Special and conditional-use permits, often referred to interchangeably, most often apply to uses that are likely to have more intensive impacts than your typical single-family home or small stand-alone commercial building. As one zoning ordinance explains, "certain uses are conditional uses instead of being allowed outright, although they may have beneficial effects and serve important public interests. They are subject to conditional use regulations because they may, but do not necessarily, have significant adverse effects on the environment, overburden public services, change the desired character of an area, or create major nuisances."[3] Quite often, projects which require conditional use permits trigger the site plan review process. For example, a zoning ordinance may permit multifamily dwellings as a conditional use in a single-family residential district. Although the use is permissible, a developer must obtain a conditional-use permit in order to proceed with the project. Sometimes this method of obtaining entitlement avoids the legislative process and is decided by an administrative board or commission, since issuing a conditional-use permit does not create a change in the zoning ordinance. There is still a risk of public outcry, however, especially if the local government's "legislative body retains the power to issue permits for certain uses, typically those that have community-wide impact."[4]

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The developer should be aware of another method for obtaining or advancing entitlement: the variance. The variance is one of the most important and commonly used techniques for changing the land use regulations which apply to particular parcels. There are two types of variances: use and area. A use variance relates to the permitted uses of the property, while an area variance relates to issues like size, setbacks, lot coverage, etc. In order to be granted a variance, a landowner must demonstrate difficulties hardships that arise as a result of the restrictions placed on the parcel by the zoning ordinance. A developer may not obtain a use variance simply because he wants to build a prohibited use on a particular piece of land; there must be some discernible hardship generated by the land, as further explained in one city's zoning ordinance, "*only* when, because of *special* circumstances applicable to the property…the strict application of the zoning ordinance deprives such property of privileges enjoyed by other properties in the vicinity and under identical zoning classification." [5] An area variance is somewhat easier to obtain because

1 David L. Callies et al, Cases and materials on Land Use 4th Edition (2004) 84

2 John R. Nolan et al., Land Use (2006) 90

3 Portland Zoning Ordinance, Section 33.815.010

4 David L. Callies et al, Cases and materials on Land Use 4th Edition (2004) 103

5 Los Angeles County's Zoning Ordinance No. 1494, Section 522

typically one must show only "practical difficulty." An example of a simple area variance would be to decrease the minimum side-yard setback so that a landowner can construct a new garage that cannot feasibly be narrow enough to satisfy the setback requirement. Often, during site plan review, a developer will seek one or more area variances in order to optimally site a building on a property; to do so, he will have to show that no feasible alternatives exist.

As zoning controls change over time, it is important to know whether new regulations apply to developments that have already begun. Any potential change in zoning regulation that will adversely affect a landowner or developer, for example a decrease in maximum density, will spur a debate about whether the developer has already established a vested right to develop the land in accordance with the less restrictive regulation. In many cases, vested rights are not established until building permits have been issued and/or substantial construction has already been completed. For the developer, the point at which he has proceeded sufficiently far enough with a project so that his right to proceed is 'vested' is sometimes difficult to define. In an notable California case,[6] the judge explained that "if the property owner/developer has incurred "substantial liabilities in good faith…he acquires a vested right to complete construction."[7] Developers often claim 'vested rights' to continue development as planned, but whether a court will find for the developer is far from predetermined or predictable. Therefore, a developer focused on a particular site would be wise to research how courts in that particular state have ruled on vested rights. In California, for example, it is more difficult to achieve vested rights because the state follows the late vesting rule in which the developer's rights have not vested until a valid building permit is issued. This is not the case in all states. The more difficult to obtain vested rights, the more uncertainty surrounding development opportunities, hence increased risk.

The vested rights issue has led some states to authorize contracts called development agreements. It has long been held that local governments cannot bargain away the police power of the sovereign to act as necessary to protect the safety, morals, public health, and welfare of the people. As such, local governments and developers cannot enter into "contract zoning" because that would in effect connote that the police power is a mere bargaining chip. However, development agreements are a legal solution under which developers and local governments can resolve issues of vested rights and community impacts. In clarifying the need for development agreements, the California state legislature highlighted a "lack of certainty in the approval of development projects," resulting in "a waste of resources" which tends to "escalate the cost of housing…to the consumer, and discourage investment in and commitment to comprehensive planning."[8] The legislature also finds that by giving developer more security, development agreements actually strengthen the public planning process, encourage private participation in comprehensive planning, and reduce the economic costs of development.[9] Not all state legislatures have passed laws authorizing development agreements, but in states that have, it is a potentially valuable option for developers.

Development agreements frequently stipulate exaction and impact fees, which are common in many development proposals but can be quite costly. Exactions can be any combination of land, infrastructure, and other fees that a local government requires from a developer in exchange for approval. Exactions are a method of transferring costs for infrastructure that is a direct result of the development. Additionally, impact fees may be assessed for off-site improvements that directly relate to the development's impact. It is critical for a developer to have some sense of legality surrounding these fees, so as to understand *why* local governments require them and also to tread carefully when it appears local government fees are excessive on the basis of nexus, rough proportionality, and/or authority from the state. Such issues are applicable because by law local government exactions must be sufficiently related and sized to the impact of the development. Although in many cases the potential value of a project far exceeds the cost of the fees, and thus developers are inclined to accept them without taking legal action, there is a well-documented

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6 Avco Community Developers, Inc. v. South Coast Regional Commission (553 P. 2d 546), Cases and Materials on Land Use 4th Edition (2004) 136

7 David L. Callies et al, Cases and materials on Land Use 4th Edition (2004) 137

8 David L. Callies et al, Cases and materials on Land Use 4th Edition (2004) 156

9 California Development Agreements Statute, Section 65864

body of case law examining the legality of exactions and impact fees, which can sometimes be so egregious as to render the project unfeasible. Again, knowing the legal background of the development process can help a developer make informed decisions and serve as a guide during entitlement.

Lastly, the Planned Unit Development (PUD) is an alternative vehicle for a developer to achieve entitlement. The PUD allows larger tracts to be developed, often with a mix of uses, at greater densities and with more design flexibility than is typically allowed in the underlying zoning district. "A PUD works as a flexible but detailed zoning device, either legislatively by rezoning to a 'floating zone' or administratively through a special or conditional use."[10] In other words, a developer should be clear about the processes to achieve PUD approval in the community in which they plan to develop. As with more basic development agreements that relate to smaller developments, local governments will often require developers to pay accordingly for the impacts of their projects.

Hypothetical Case

The following hypothetical, loosely based on a real case, demonstrates some of the difficulties associated with both the formal and informal steps in the approvals process, and illustrates some of the considerations a developer must make within the entitlement process. Whatever the absolute merits of the project, the developer's decision to continue, revise, hold, or pass on the project is largely a function of the success of the entitlement process. In this case, the formal and informal approval processes, as described earlier in the paper, are concurrent, but it is primarily the informal discussions that lead the developer into risky territory.

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LandCo has long been successful in one of the country's largest cities. Originally a residential and retail developer, LandCo has developed significant, well-known mixed-use projects in their city and elsewhere around the country. For many years, LandCo has created value through the entitlement and development process.

This particular project is in a city an hour's drive from a large metropolitan area. Over the past several years, the community had seen increased residential and commercial activity. LandCo, looking to enter the market, found a location suitable for new retail development and entered into a purchase and sale agreement to buy the land subject to a lengthy due diligence period. LandCo's plan for the site includes a retail strip building and several outparcels.

LandCo planned to gain approval for a PUD—encompassing an annexation agreement, several conditional-use permits, and variances—and receive building permits within 18 months. Following their traditional model of working closely with communities to garner approval, LandCo approached the city to discuss its plan.

First, LandCo called the Director of Community Development to discuss the PUD. The director suggested LandCo look into purchasing adjacent blighted properties. Soon thereafter, LandCo met with the director, who indicated the city's willingness to provide financial and political support if LandCo purchased one of the adjacent properties. LandCo reworked the site plan to include the adjacent parcel.

After a year of predevelopment, LandCo had a successful 'workshop' with the planning board. One powerful alderman indicated that he would support the project so long as LandCo went through with its purchase of the adjacent parcel. At the same time, however, he rejected the possibility of city assistance. Around this time, LandCo closed on the original parcel and entered into an agreement to purchase the adjacent parcel for 200% its appraised value.

Almost two years into a process that was slated to take 18 months, the planning board voted unanimously in favor of recommending the project to City Council. The City subsequently asked LandCo to look at big-box possibilities for the site and its adjacent parcels. LandCo found an interested big-box tenant but the land was too costly to make its tenancy feasible, delaying LandCo another three months.

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[10] David L. Callies et al, Cases and materials on Land Use 4th Edition (2004) 170

Finally, LandCo went before the City Council for PUD approval. The alderman, whom LandCo thought was in support of the plan, moved to deny the petition. As a result, LandCo withdrew its plan before a vote could be cast. Confident that the deal is ultimately valuable, LandCo went back to the drawing board, expecting another six months until final approval. LandCo approached this process correctly but was delayed because they misread one powerful individual. To some degree LandCo successfully navigated the formal process and failed the informal process. First, LandCo evaluated the deal and correctly decided a PUD would achieve greatest flexibility. They were quick to initiate the approvals process and eventually achieved unanimous planning board approval. LandCo reviewed and accommodated a number of city requests and were poised for PUD approval.

The alderman who ultimately moved to deny this plan was heavily involved in city land-use regulations and had strong influence within City Council. Without more details his attempt to condition his approval on the purchase of a parcel seems noteworthy. How would the adjacent parcel play into LandCo's project? How would the purchase advance community interest? Who owned the adjacent parcel? Can the alderman informally (verbally) condition his approval on that purchase? After incorporating the adjacent parcel into the plan it appears LandCo assumed the alderman was now on board. But they then failed to communicate and verify his newfound support. Had LandCo done so, the project may have been only marginally—not significantly—delayed. As with this hypothetical scenario, many projects are broken or delayed because the informal approval process breaks down into formal rejection.

Conclusion

The development approval process can be challenging to navigate. Much of what drives the process are informal conversations and underlying legal principles. Often a fragile perception of understanding pushes projects along. As municipal considerations change, competing agendas upend the process. As the market changes, developers amend their course of action. However, through preparation, patience, and perseverance, those who are willing to engage the entitlement process have the opportunity to create tremendous value in real estate.