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Development Agreements: The Intersection of Real Estate Finance and Land Use Controls

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DEVELOPMENT AGREEMENTS: THE INTERSECTION OF REAL ESTATE FINANCE AND LAND USE CONTROLS

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I. INTRODUCTION

Real estate plays an integral role in the United States economy. It constitutes close to two-thirds of the United States wealth and represents almost one quarter of its gross national product.[1] Recent years have seen a decline in the real estate market.[2] This collapse has negatively impacted banks and other financial institutions, which

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1. Adrienne Linsenmeyer, *The Worst Market Collapse in Decades, and Its Likely Repercussions*, FIN. WORLD, Nov. 12, 1991, at 26. The 1980s were an extreme boom period for the real estate development market. This was partly related to extensive deregulation of bank real estate lending under the Garn-St. Germain Act of 1982, as well as the availability of huge amounts of investment capital. *Id.* The Garn-St. Germain Act of 1982 abolished loan to value limits for real estate projects, restrictions on loans for undeveloped land, and the previous requirement that developers maintain an equity stake in their projects. The Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.). *See generally* Roger M. Zaitzeff & Daniel J. Mette, *Investment Powers of Federal Savings & Loan Associations After Garn-St. Germain*, 36 U. FLA. L. REV. 591 (1984) (providing complete overview of savings and loan associations' investment powers following passage of Act).
2. *See, e.g.*, Robert L. Clarke, *How OCC Will Manage*, NAT'L MORTGAGE NEWS, Oct. 7, 1991, at 4 (linking real estate decline to regional economic collapse); Eugene J. Marcus, *Real Estate Defaults*, N.Y. L.J., Sept. 25, 1991, at 5 ("With the collapse of the real estate market in the last few years the grim subject of dealing with defaults has come upon the market like a tidal wave and these dire conditions give promise of continuing well into the future."); Richard D. Hylton, *Real Estate Woes Seen Worsening*, N.Y. TIMES, Nov. 19, 1990, at D1 (predicting continued decline of real estate market related to poor economy and lack of available credit); Steve Kerch, *Developers Hear the Bad News: 90s to Be Nasty*, CHI. TRIB., May 7, 1989, REAL EST., at 1 (reporting speech at Urban Land Institute seminar, predicting "disastrous" real estate market in 1990s).

provided much of the funding for the real estate boom of the 1980s.[3] Increasingly, financial institutions are finding themselves faced with the choice of writing off bad real estate loans or foreclosing on property not worth the loan that it secures.[4] Lenders are also faced with additional risks and liabilities not anticipated in making the original loans.[5] In response to these risks and liabilities, financial

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3. During the 1980s it was not unusual to find banks financing 100% of real estate development project costs. Linsenmeyer, *supra* note 1, at 26. Today the vacancy rate for office space stands at 18.7%. Banks have been forced to write off large amounts of real estate loans. Linsenmeyer, *supra* note 1, at 26; Jerry Knight, *Enforcement Action Against Sovran Disclosed*, WASH. POST, Aug. 15, 1991, at B12 (finding that Sovran Bank has set aside $714 million to cover real estate write offs); *Citicorp: Cutbacks Paying Off*, USA TODAY, Sept. 23, 1991, at 1B (stating that Citicorp has set aside over one billion dollars to cover real estate loan losses); James Bates, *Real Estate Developers Threat to State's Banks*, L.A. TIMES, Sept. 22, 1991, at D1 (stating that Bank America anticipates one billion dollar write off of Security Pacific real estate loans in merger); *see also* Hylton, *supra* note 2 (discussing interaction between real estate market and banking industry, and indicating that lenders in many situations are faced with renegotiating loan terms with borrowers). In addition to write offs, real estate lenders are increasingly foreclosing on property. *See, e.g.*, David Barry, *Lenders Wall In Morocco*, BUS. J. SAN JOSE, Oct. 7, 1991, § 1, at 1 (discussing numerous foreclosure actions filed since August against real estate developer for loans ranging from $2 million to $55.8 million); Charles V. Zehren, *Payment Demanded; Lenders Move to Foreclose on Former Roosevelt Raceway*, NEWSDAY, Oct. 4, 1991, at 7 (discussing foreclosure by lenders of Roosevelt Raceway where real estate developer failed to make payment of approximately $32 million).
4. *See* Zehren, *supra* note 3 (discussing foreclosure of Roosevelt Raceway, which due to declining real estate values is no longer worth loan it secures); *see also* Stephen Kleege, *$300 Million Bankruptcy Plan Highlights Plunge in Connecticut*, AM. BANKER, Sept. 13, 1990, at 30 (detailing liquidation plan of developer owing $300 million, secured by properties valued at $130 million).
5. Liability has been imposed upon lenders for environmental clean up costs. *See, e.g.*, United States v. Maryland Bank & Trust, 632 F. Supp. 573 (D. Md. 1986) (holding bank obtaining title to hazardous waste disposal site through foreclosure proceedings, liable for costs associated with clean up under CERCLA, 42 U.S.C. § 9607(a)(1) (1988)); United States v. Fleet Factors, 901 F.2d 1550 (11th Cir. 1990) (indicating that creditor who engaged in financial management of property is potentially liable for CERCLA clean up costs); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20, 994 (E.D. Pa. 1985) (finding issue of fact as to whether lender was sufficiently involved in management of hazardous waste site to subject it to CERCLA liability). *See generally* Bernard J. Berry et al., *Superfund Liability for Financial Institutions*, 96 COM. L.J. 59 (1991) (examining liability of creditors for environmental clean up costs associated with secured property used as hazardous waste storage); Susan C. Geiser, *Federal and State Environmental Law: A Trap for the Unwary Lender*, 1988 B.Y.U. L. REV. 643 (1988) (discussing potential imposition of liability, or effect on priority interests of mortgagee, resulting from state and federal environmental laws).

   Additionally, lenders have been exposed to liability under a number of institutions have established a variety of mechanisms designed to minimize exposure in real estate development lending.[6]

In a parallel development to the real estate crisis, local governments have faced increasing fiscal pressure and budget crises as they confronted cut backs in aid at both the state and federal level throughout the 1980s.[7] Aggravated by an economic downturn, the fiscal situation of local governments shows no sign of improving in the near future.[8] Forced to bear greater portions of the costs asso-

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common law theories of recovery including breach of a duty of good faith, breach of fiduciary duty, and breach of contract. *See* Frances E. Freund, Note, *Lender Liability: A Survey of Common-Law Theories*, 42 VAND. L. REV. 855 (1989) (surveying traditional and emerging theories of lender liability that have resulted in multimillion dollar damage awards); A. Barry Cappello & Frances E. Komoroske, *Lender Liability: What Lies Ahead*, TRIAL, May 1991, at 68 (examining recent trends in imposition of lender liability in such areas as failed leveraged buyouts, failing savings and loan associations, and environment). *See also* ALVIN L. ARNOLD, CONSTRUCTION AND DEVELOPMENT FINANCING, ¶ 4.26 (2d ed. 1991) (liability to third parties), ¶ 4.27 (liability to borrower), ¶¶ 8.01-8.06 (liability under CERCLA) (discussing lender liability in construction and development financing).

6. *See* Berry et al., *supra* note 5, at 73-76 (suggesting different manners in which lending institutions may limit liability, including performance of "environmental due diligence" and requiring posting of bonds, guarantees, or maintenance of environmental clean up insurance as prerequisite to lending); Geiser, *supra* note 5, at 693-703 (examining role of title insurance and inclusion of warranties and covenants in mortgage documents as limitations on lender exposure for clean up costs); N. Sue Van Sant Palmer, Note, *Lender Liability and Arbitration, Preserving the Fabric of Relationship*, 42 VAND. L. REV. 947 (1989) (indicating that imposition of lender liability leads to defensive posture by lending industry and suggesting that arbitration might provide help in resolving disputes and reducing liability). *See generally* ARNOLD, *supra* note 5, ¶ 8.04 (discussing ways to reduce risks associated with CERCLA liability). *See also* John A. DeAngelis, Note, *Riches Do Not Last Forever: Real Estate Investment By National Banks*, 1991 U. ILL. L. REV. 777, 786 (discussing recent innovations in real estate financing including shared appreciation and convertible mortgages to which the banking industry has turned to reduce its risk and increase returns).

7. John J. Kirlin, *The Bargaining Process: Trends and Issues*, *in* MANAGING DEVELOPMENT THROUGH PUBLIC/PRIVATE NEGOTIATIONS 1, 2 (Rachel L. Levitt & John J. Kirlin eds., 1985) (discussing changing fiscal situation for local governments based on enactment of statutory spending limitations, such as California's Proposition 13, and decreases in federal aid); Lindsey Gruson, *End of Federal Revenue Sharing Creating Financial Crisis in Many Cities*, N.Y. TIMES, Jan. 31, 1987, § 1, at 7 (examining impact of elimination of federal aid program of general revenue sharing on local governments and finding that between 1978 and 1985 federal aid to municipalities declined by 22.1%). *See generally* CRISIS AND CONSTRAINT IN MUNICIPAL FINANCE, xvii (James H. Carr ed. 1984) [hereinafter CRISIS AND CONSTRAINT] (providing general overview of fiscal situation facing local government and indicating that federal capital investment has declined 30% between 1965 and 1980).

8. Stephen A. Davies, *Threat of Economic Downturn Forces City Officials to Take Stock*, BOND BUYER, Dec. 3, 1990, at A1 (considering financial situation

ciated with the creation and maintenance of local infrastructure, municipalities have developed novel financing devices, which are often employed through the local land use regulatory scheme.[9] These devices have served to shift many of the infrastructure costs, historically born by municipalities in supporting and absorbing the externalities associated with private development, to the private developer itself.[10]

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of local government, in light of combined impact of economic downturn and cut backs in federal funding on local finances, and finding that federal funding per capita has declined from $77.95 in 1981-82 to $48.64 in 1987-88).

9. Kirlin, *supra* note 7, at 21. Municipalities have responded to financial pressures by developing and expanding upon tax exempt financing and the use of municipal bonds. *Id.* (discussing evolution of municipal financing development techniques in response to cut backs in federal aid); Paul B. Downing, *User Charges and Service Fees, in* CRISIS AND CONSTRAINT, *supra* note 7, at 160-220 (discussing use of user fees both as revenue source and cost reduction mechanism for government services and public facilities); Randy Hamilton, *The World Turned Upside Down—The Contemporary Revolution in State and Local Government Capital Financing, in* CRISIS AND CONSTRAINT, *supra* note 7, at 200-20 (outlining innovations in state and local government bond markets, including zero coupon bonds, compound interest bonds, stripped coupon bonds, tender option (put) bonds and super sinker bonds, as well as new methods of tax exempt financing, such as tax exempt commercial paper and tax exempt lease financing).

   Additionally, local governments have begun to turn to mechanisms that serve to transfer the costs of infrastructure development to real estate developers. *See generally* Gus Bauman & William H. Ethier, *Development Exactions and Impact Fees: A Survey of American Practices*, 50 LAW & CONTEMP. PROBS. 51 (1987) (surveying national development exactions, dedication practices, and user fees).

10. *See* Kirlin, *supra* note 7, at 15-16 (discussing changing roles of public and private participants, and trends away from traditional role of local government in supplying infrastructure to real estate development sites and eliminating surrounding blight conditions); *see also* Roger D. Feldman et al., *Public-Private Partnership for Infrastructure Development, Financing Infrastructure: Tools For the Future* (1988), *reprinted in* 1989 ZONING AND PLANNING LAW HANDBOOK 363 (Mark S. Dennison ed.) (providing overview of implementation of public-private partnership in provision of community services). *See generally* David L. Callies & Malcolm Grant, *Paying for Growth & Planning Gain: An Anglo-American Comparison of Development Conditions, Impact Fees, and Development Agreements*, 23 URB. LAW. 221, 221 (1991) (comparing United States and British experiences in attempting to transfer external costs associated with real estate development to private developer).

   The question remains as to who actually ends up paying for these externalities in the long run; it seems likely that the costs are shifted back to the public by the developer's raising of prices. *See* Kirlin, *supra* note 7, at 6 (identifying effect of shifting of costs to developers as tendency to pass such additional costs onto tenants of development and to attempt to reduce costs associated with initial land acquisition); *see also* Arnold, *supra* note 5, ¶ 2.03[2][a] (discussing impact of fee imposition upon financing process and indicating that developer has four methods of dealing with added costs: (1) passing costs on through lease or purchase price; (2) including fee as part of costs; (3) absorbing costs; or (4) a combination thereof).

Development agreements are one of the mechanisms created to define specific area land uses, as well as accomplish the internalization of real estate development externalities.[11] The agreements are essentially contracts entered into by a municipality and a developer, with each party having corresponding duties and obligations.[12] From the real estate developer's perspective, the development agreement vests or conveys a right to develop according to an initial plan[13] in exchange for the developer's assumption of responsibility of delineated infrastructure improvements and additions.[14] Thus, while the development agreement may increase the monetary cost of a particular project,[15]

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11. *See* Richard Cowart, *Experience, Motivations, and Issues*, *in* DEVELOPMENT AGREEMENTS: PRACTICE, POLICY AND PROSPECTS 9, 30 (Douglas R. Porter & Lindell L. Marsh eds., 1989) [hereinafter DEVELOPMENT AGREEMENTS] (identifying public motivations underlying use of development agreements within California as related to provision of infrastructure); Douglas R. Porter, *The Relation of Development Agreements to Plans and Planning*, *in* DEVELOPMENT AGREEMENTS, *supra*, at 148-49 (evaluating development agreements as alternative planning mechanism); *see also infra* notes 136-78 and accompanying text (discussing vested rights doctrine, evolution of development agreements, and underlying policy rationale).
12. Callies & Grant, *supra* note 10, at 240 (contrasting bilateral nature of development agreements with conditional or contract zoning based on unilateral covenants); Michael R. Fry, Comment, *Modern Development: Vested Rights or Development Agreements*, 55 UMKC L. REV. 483, 484 (1987) (stressing that mutuality forms essential component of development agreements rendering them effective); *see also infra* notes 139, 141, 143 and accompanying text (discussing contractual nature of development agreement).
13. Callies & Grant, *supra* note 10, at 239 (stating that primary advantage of development agreements is ability to vest development rights in developer); *see also* Lindell L. Marsh, *Introduction*, *in* DEVELOPMENT AGREEMENTS, *supra* note 11, at 2, 3 (asserting that primary purpose of development agreements is "to assure the developer that the rules of the game will not change").
14. *See* Callies & Grant, *supra* note 10, at 239 (opining that developer will undertake additional infrastructure costs in order to ensure certainty of development rights, rendering development agreements bilateral in nature); Marsh, *supra* note 13, at 3 (finding that agreements encourage developer provision of infrastructure and public benefits, as well as providing "greater predictability and less risk" in planning and development); *see also* Cowart, *supra* note 11, at 33 (reviewing California experience with development agreements in 10 years following statutory enactment and finding that "[m]any jurisdictions financed public infrastructure and services with development agreements"). Cowart's article provides a summary of a survey conducted by the University of California in 1985-86. This survey found that in a sampling of development agreements, 57.5% contained provisions requiring infrastructure or public facility improvements and 35% required some type of land dedication. *Id.*; *see also infra* note 15 and accompanying text (discussing exactions imposed upon developer).
15. *See* ARNOLD, *supra* note 5, ¶ 2.03[2][a] (outlining various types of fees and exactions imposed in subdivision regulation process and asserting that local government should not "assume that impact fees are simply costs to be absorbed

it generates a substantial benefit to the developer by freezing the applicable land use scheme and conveying the right to develop.[16]

On the other hand, from the municipality's perspective, the agreement shifts the external costs associated with the increased need for and demands on public infrastructure to the developer. This reduces the fiscal pressure placed on the local government.[17] Furthermore, development agreements enhance the municipality's ability to develop a more complete and comprehensive plan, and ensure that real estate developers will complete development and its corresponding infrastructure in a timely manner.[18] In return for these benefits, development agreements oblige the local government to maintain or freeze the zoning or land use scheme, as applied to that specific piece of property, for a specified period of time.[19]

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by the developer"). Arnold discusses the effect of impact fees on the financing process and states that "a fee represents a cost to the developer, and that cost must be accommodated somewhere in the project." *Id.*; *see also supra* note 10 and accompanying text (indicating that developers will attempt to pass costs associated with exaction onto purchasers or lessees of completed development); *cf.* James C. Nicholas, *Impact Exactions: Economic Theory, Practice and Incidence,* 50 LAW & CONTEMP. PROBS. 85, 95-98 (1987) (discussing the reality of who absorbs costs associated with different types of exactions and outlining such factors as uniformity, predictability, and timing of imposition and payment, as factors affecting developer's ability to shift costs forward or backward); Charles Siemon, *Who Bears the Cost?*, 50 LAW & CONTEMP. PROBS. 115, 126 (1987) (considering implications of additional costs associated with exactions and impact fees for housing costs and potentially resulting discriminatory impact).

16. *See* Fry, *supra* note 12, at 483-84 (indicating that developer may be required to expend substantial start up costs that are rendered useless if development right fails to vest and implying that development agreements minimize risk); *see also infra* notes 31-40 and accompanying text (illustrating consequences posed to development project with no vested right by changing land use scheme).
17. *See supra* notes 10, 11, 14, 15 and accompanying text discussing use of development agreements in requiring developers to provide infrastructure and public facilities in return for vesting of development rights.
18. Marsh, *supra* note 13, at 3-4. Marsh outlines the public purposes underlying development agreements as:

    1. Private absorption of externalities relating to development through provision of infrastructure and public services;
    2. Injection of greater predictability and corresponding reduction in costs of development;
    3. Provision of flexibility in negotiation between public and private sectors.

    Id. Additionally, development agreements may serve as an integral part of the land use planning process. *See* Porter, *supra* note 11, at 148-51 ("[B]y specifying the phasing and timing of development, in designated areas, development agreements provide a coordinating mechanism for future capital outlays and other public actions.").
19. *See supra* note 12 and accompanying text (discussing bilateral nature of development agreements and primary benefit to developer as vesting of right to develop).

This Article proposes that, in addition to the traditional benefits associated with development agreements, they serve as additional security in the real estate financing process by eliminating the uncertainty and risk posed by an unstable land use regulatory scheme. In support of this thesis, this Article argues that, as a vested right, development agreements convey property rights that increase the value of the collateral mortgaged in the financing process. Section II illustrates the problem posed by a changing land use regulatory scheme vis-a-vis a developer who has not yet obtained a vested property right in development. Section II also illustrates the consequences a development agreement may have for the financier of a real estate development project.

Section III provides an overview of the real estate development finance process, outlining the risks that confront lenders and that diminish the availability of credit for real estate development. This section's focus is primarily on the attendant concerns of construction financing with stress on the issues raised in real estate component financing. It concludes with a summary of the lender's remedies upon default of the mortgagor.

Section IV provides an overview of the legal bases and implications of development agreements. This section outlines the present regulatory scheme and substantive requirements of development agreements. In addition, section IV also delineates the traditional purposes underlying the creation of the development agreement. Finally, it addresses the constitutional implications of such agreements.

Section V develops the proposition that the proper structuring of the development agreement will not only extend its traditional benefits of providing the developer with a vested right and relieving the municipality of a particular fiscal stress, but it will also enhance the creditworthiness of the proposed development. The premise of section V is that a development agreement, to the extent that it represents a vested right in development, conveys a property interest to the developer, which enhances the value of the property to be mortgaged in the financing process. It develops this premise first by examining and delineating the terms and structure of the development agreement necessary to render it a viable financeable device, and second by addressing the issue of enforceability and assignability of the development agreement by the lender.

II. LAND USE AND THE REAL ESTATE DEVELOPMENT PROCESS

This section delineates the problems that a changing land use regulatory scheme imposes on the real estate development process. It also illustrates, from the lender's perspective, the consequences an inadequately drafted development agreement can create. While the consequences illustrated may represent the extreme case, it is clear that either the failure to obtain vested rights in the development process associated with a changing land use regulatory scheme, or an improperly drafted development agreement, may pose significant consequences for the real estate financing process.

A. Changing Land Use Scheme—No Vested Right

Zoning ordinances, comprehensive plans, and subdivision regulations regulate the residential, commercial, and industrial composition of almost every municipality in the United States.[20] Real estate development projects are also subject to permitting processes.[21] The various mechanisms governing the zoning and building processes constitute a municipality's land use scheme. Local legislative and administrative bodies regulate and control this land use scheme.[22] The scheme is periodically revised through comprehensive rezonings.[23]

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20. *See* Mendes Hershman, *A Lender Looks at Land Use Controls: The Wonder World of Fixed and Floating Zones, Subdivision Regulations, and Master Plans* (pts. 1-3), 12 PRAC. LAW. 11, 15 (1966), 13 PRAC. LAW. 51, 75 (1967); *cf.* Lisa Belkin, *Houston Journal: Now That a City Has Grown, The Planning Begins*, N.Y. TIMES, Feb. 10, 1991, at 20 ("Houston is the only major American city with no zoning regulations . . . ."). Land use regulations find their genesis in the common law of nuisance and they developed in response to public demand for some type of control over sprawling development as well as real estate's need for assurance of property values. Hershman, pt. 1, *supra* at 12-13; *see also* DANIEL G. HAGMAN & JULIAN CONRAD JUERGENSMEYER, URBAN PLANNING & LAND DEVELOPMENT CONTROL LAW § 2.7 (1986) (indicating that underlying purposes of zoning regulations range from maintenance of property values, neighborhood stabilization, traffic regulation, limitation on density, and promotion of morals, to increasing tax base). New York City enacted the first comprehensive zoning law in 1916. *Id.* In 1926, the Supreme Court upheld such comprehensive land use regulations as valid exercises of the police power. Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926).
21. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, §§ 8.1, 8.6 (discussing building and housing codes, and indicating that "issuance of a building permit is usually the last point at which the local government can exercise leverage regarding the type of development that will be permitted in the land"); *see also* 33 U.S.C. § 1311(a) (1988) (requiring federal permit for filling of property classified as wetlands). The import of the federal permit requirements under the Clean Water Act on real estate development is the subject of much recent commentary. *See, e.g.*, Thomas Hanley, Comment, *A Developer's Dream: The United States Claims Court's New Analysis of Section 404 Taking Challenges*, 19 B.C. ENVTL. AFF. L. REV. 317 (1991).
22. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, §§ 3.6-3.11 (indicating that zoning is primarily delegated to local government under state police power).
23. *See* Paul B. Rodbell & Cathleen F. Ward, *Vesting Development Rights in Maryland*, MD. B.J., May/June 1992, at 23 ("The basic method by which land uses are amended unilaterally by the local zoning authority is through a comprehensive rezoning of the area. Comprehensive rezoning arises periodically when the legislative body revises the zoning designations for an area in light of the existing land uses and future needs of their community.").

In addition, spot or piecemeal zoning may occur on a site specific basis.[24] More recently, local communities have begun to experiment with a variety of growth control mechanisms, including moratoria[25] and exactions, which impact on the real estate development process.[26] All of this adds up to a complex regulatory scheme that is potentially subject to change at any point in time.[27] A real estate developer must comply with the terms of the applicable land use scheme.[28] Furthermore, a real estate project must comply with any subsequent changes to the applicable land use scheme up until the point at which the developer obtains a vested right in the development.[29] In other words, there is no inherent right to a particular zoning classification just because a developer has commenced a project.[30]

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24. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, §§ 5.4-5.6 (providing overview of spot, contract, and piecemeal zoning); *see also* Judith W. Wegner, *Moving Toward the Bargaining Table: Contract Zoning, Development Agreements, and the Theoretical Foundation of Government Land Use Deals*, 65 N.C. L. REV. 957, 977-94 (1987) (examining character of such rezoning techniques and indicating that while traditionally such rezoning was viewed as inherently suspect, present day trend is towards rejecting per se invalidity and applying rule of reason).
25. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, § 9.5; *cf.* Lucas v. South Carolina Coastal Council, 112 S. Ct. 2886 (1992) (applying constitutional takings analysis to state statute prohibiting construction on beachfront property).
26. The term exactions encompasses user or impact fees as well as land dedications. An exaction may also require a developer to fund or construct various infrastructure requirements of the proposed development. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, §§ 9.1-9.9 (discussing proliferation of growth management techniques in response to environmental concerns and budgetary constraints, based on notion that developers should pay their own way); Bauman & Ethier, *supra* note 9, at 57-59 (surveying national practices in imposition of development exactions and user fees and concluding that 65.9% of responding communities maintained policy of on-site development exaction, 39.6% maintained off-site exaction policy, and 36.4% utilized some type of impact fee structure).
27. *See* Robert M. Kessler, *The Development Agreement and Its Use in Resolving Large Scale, Multi-Party Development Problems: A Look at the Tool and Suggestions for Its Application*, 1 J. LAND USE & ENVTL. L. 451, 451-53 (1985).
28. *See* Rodbell & Ward, *supra* note 23, at 22 ("A builder must seek approval for a project and obtain numerous permits from various authorities, as well as conform to local land use regulations, numerous zoning ordinance requirements, and comprehensive plans.").
29. A developer has no inherent guaranteed or vested right in real estate development. A development is subject to all changing land use laws and regulations until a right in the development has vested. Grayson P. Hanes & J. Randall Minchew, *On Vested Rights to Land Use and Development*, 46 WASH. & LEE L. REV. 373, 390 (1990) (citing cases).
30. *See* Rodbell & Ward, *supra* note 23, at 23 ("A property owner does not acquire a right to a particular zoning designation . . . ."); *cf.* P-W Investment, Inc. v. City of Westminster, 655 P.2d 1365 (Colo. 1982) (holding that com-

The risks associated with a changing land use regulatory scheme are substantial and, in fact, act as a deterrent to the availability of credit with which to finance real estate development.[31] *Avco Community Developers v. South Coast Regional Commission*[32] illustrates the risks posed by a changing regulatory scheme on the development process, where no vested right to develop has inured. In *Avco*, the developer had incurred close to three million dollars in start-up costs related to a proposed coastal development project.[33] Subsequent to

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pletion of preliminary improvements did not create a vested right or entitlement to water services).

31. *See* ARNOLD, *supra* note 5, ¶ 3.02[4] (identifying zoning and building requirements as risks to be evaluated in financing real estate construction); *see also supra* notes 5, 15 and *infra* notes 69, 81, 82, 86, 87, 135 and accompanying text (discussing considerations related to land use regulation in the financing process). The impact that changes in land use regulation have on the value of property, or the developer who has commenced development but has no vested right in the development process, may be extreme. *See* Bob Lane, *County's Surprise Cost Him $130,000—Property Classified as Wetlands, But Nobody Told Him*, SEATTLE TIMES, Dec. 24, 1991, at A1 (recounting story of individual who purchased property as investment, which was subsequently reclassified as wetlands, rendering it nearly impossible for him to resell to developer). For a good discussion of the impact of wetlands legislation on the real estate development process, see David Gill, *The Wetlands Wading Game*, BUS. J.—N.J., Feb. 1990, at 50 (discussing impact of 1987 wetlands legislation on real estate development in New Jersey and finding that in one housing development project up to 120 of 375 planned units may be lost in complying with requirements); *see also* Mays-Ott Co. v. Town of Nags Head, 751 F. Supp. 82, 87 (E.D.N.C. 1990) (upholding developer's vested right in partially completed development project but stating that the "expenditures of a substantial amount of money on the commencement of a project [does not] create a vested right to complete the project"); Rita Fitzgerald & Richard Peiser, *Santa Monica's Colorado Place Agreement*, *in* DEVELOPMENT AGREEMENTS, *supra* note 11, at 40 (discussing well publicized $200 million development project in California, which experienced numerous problems and delays related to regulatory land use environment). This particular development agreement is discussed further, *infra* notes 33, 53, 85; *cf. Top 10 Changes in Real Estate Over the Past Decade*, BUS. WIRE, Jan. 15, 1990, available in LEXIS, Nexis Library (identifying "exaction zoning" and "zoning for sale" as major developments in 1980s impacting on real estate industry); Steve Kerch, *The War Room: Predicting Land Value For 10, 15 Years*, CHI. TRIB., Apr. 22, 1990, at 1D (stating that government policy in area of zoning and land use regulation is one of key considerations in valuing real estate for land acquisition).
32. 553 P.2d 546 (Cal. 1976), *cert. denied*, 429 U.S. 1083 (1977).
33. *Id.* at 549. These expenditures were made in reliance on the 1972 approval of a final map for the development, as well as the issuance of an initial permit. *Id.* Similarly, in the Colorado Place development project, noted *supra* note 31, the developer had expended two million dollars in start up costs on a proposed mixed use project. Fitzgerald & Peiser, *supra* note 31, at 41. The developer incurred these costs following the issuance of an initial permit

the expenditure, but prior to obtaining a building permit, the State of California enacted the California Coastal Zone Conservation Act of 1972,[34] which created another permit requirement and approval stage in the proposed development project.[35] The developer sought an exemption under the Act, claiming a vested right in the proposed development based on its expenditures made in reliance on prior zoning and government authorizations.[36] The California Supreme Court refused to find that the developer had a vested right in the proposed development and therefore denied the developer's request for an exemption under the Act.[37] The court noted that the developer could still pursue the option of complying with the terms of the Act and attempt to acquire the additional permit. It continued, however, by stating that "if the application is denied, then the desired buildings on the tract *cannot be* constructed during the period the Act is in effect."[38] Consequently, the developer faced the possibility that it could never complete the development, notwithstanding its substantial expenditures and incurred liabilities.[39] The possibility of such consequences obviously poses a substantial risk to potential real estate lenders: risks that they may not be willing to assume.[40]

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authorizing preconstruction work. *Id.* Subsequently, a newly elected city council passed a commercial building moratorium. *Id.* The developer was faced with the fact that it had incurred substantial liabilities but no vested right in continued development. *Id.* It subsequently entered into negotiations with the local legislature, which eventually evolved into a development agreement between the municipality and the developer. *Id.*; *see also* Prince George's County v. Sunrise Dev. Ltd. Partnership, 330 Md. 297, 300, 623 A.2d 1296, 1298 (1993) (holding that developer who had incurred start up costs of $2,150,845.00 had no vested right in project's development).

34. Cal. Pub. Res. Code §§ 27000-27650 (West 1972) (repealed 1977) (establishing coastal zone conservation commission and authorizing creation of conservation plan and permit procedures). The 1972 Act was subsequently repealed and replaced with the California Coastal Act of 1976. Cal. Pub. Res. Code §§ 30000-39000 (West 1986). *See* Ward Tabor, *The California Coastal Commission and Regulatory Takings*, 17 Pac. L.J. 863 (1986) (discussing the interaction between California coastal legislation and its effect on property rights).

35. *Avco*, 553 P.2d at 548. The permit provision exempted those developers who had obtained a vested right prior to its enactment. *Id.*

36. *Id.* at 549.

37. *Id.* at 557.

38. *Id.* (emphasis added).

39. *Id.*

40. *See supra notes* 15, 31 and *infra* notes 53, 81, 82, 85, 86, 135 and accompanying text (discussing impact of changing land use regulation on financier's willingness to extend credit); *see also* P-W Investment, Inc. v. City of Westminster, 655 P.2d 1365, 1367 (Colo. 1982) (evaluating whether vested right had inured in development where both the developer and lender brought suit in effort to obtain water and sewer tap hook-ups integral to project's completion).

B. *Development Agreements—Consequences to the Lender*

Development agreements can reduce the risks identified in the *Avco* case by freezing the regulatory scheme, and thus implicitly conveying vested development rights.[41] Nevertheless, as with any document affecting real property, such an agreement also poses substantial risks if it is ineffectively drafted.

Mayor of Rockville v. Walker[42] illustrates the extreme consequences a development agreement may pose to a lender's security interest.[43] In *Walker*, the town of Rockville and the developer entered into a development agreement, which included a provision transferring municipally owned land to the developer in return for specified consideration.[44] The agreement further detailed certain terms governing the development. Subsequently, the developer, after obtaining construction financing,[45] failed to comply with the terms of the development agreement and eventually defaulted on the loan.[46] In 1988, the court construed the conveyance by development agreement as a defeasible estate subject to a condition subsequent, vesting the power of reentry in the municipality upon a breach of the terms of the agreement by the developer.[47] The right of reentry potentially vested a superior property interest in the city that threatened to extinguish the lender's security interest in the mortgaged property.[48]

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41. *See infra* notes 232-41, 251 and accompanying text (proposing that development agreements create and convey vested property rights and thus inject greater security into the land use development process).
42. 86 Md. App. 691, 587 A.2d 1179 (1991).
43. In Maryland, there is no statutory basis for development agreements between local government and private developers; however, the court did not specifically address the issue of the validity of the agreement itself. In Maryland, there is common law authority for such development agreements. *See* Mayor of Baltimore v. Crane, 277 Md. 198, 352 A.2d 786 (1976) (construing ordinance as creating vested contractual right in private party); *see also infra* notes 152-57 and accompanying text (discussing *Crane* case as legal basis for development agreements).
44. *Walker*, 86 Md. App. at 694, 587 A.2d at 1180. For an article discussing the problems associated with Rockville Metro Center's development and its effect on a real estate developer, see Rick Greenberg, *Busted in Bethesda: The Story of Roger Eisinger and John Kilbane, Once the Barons of Their Busting Suburban City, Offers a Lesson In Concentration and Succession*, REGARDIES, Nov. 1990, § 1, at 27.
45. *Walker*, 86 Md. App. at 694, 587 A.2d at 1180. A deed of trust secured the loan on the attendant property. *Id.* Furthermore, the developer never notified the City of the transaction. *Id.*
46. *Id.* The developer defaulted on the loan six months prior to the City's declaration of the loan to be in default under the terms of the agreement and the corresponding demand of performance. *Id.*
47. Hadid Land Dev. Corp. v. Mayor of Rockville, No. 1339, slip op. at 24 (Md. Ct. Spec. App. May 16, 1988).
48. *Walker*, 86 Md. App. at 695-700, 587 A.2d at 1181-83. The court pursued a

The lender, in pursuing its right of foreclosure, faced the fact that the development agreement might render it an unsecured creditor. The development agreement, however, contained a subordination clause that delineated the extent to which the agreement would be subordinated to a financing interest.[49] The case was remanded for further findings on whether the loan fell within the terms of the subordination provision, thereby protecting the lender's security interest.[50]

Walker indicates that an inadequately drafted development agreement may carry the extreme consequence of destroying the mortgagee's security interest in the development.[51] This resulted from the fact that the development agreement directly affected title to the property in interest.[52] More commonly, the complexity of a development agreement can lead to unexpected breach or default and thus, impact upon the development's completion.[53] Failure by the developer to consider a development agreement's implications to a potential mortgagee's interest in the development may adversely impact on the developer's ability to obtain financing for the development.

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discussion of the impact of defeasible estates upon a mortgagee's security interest and concluded "that a mortgagee's interest similarly ends when a grantor exercises the power of termination in the case of a fee simple subject to a condition subsequent." *Id.* at 669, 587 A.2d at 1183.

49. *Walker*, 86 Md. App. at 599-704, 587 A.2d at 1183-85. The development agreement contained a section entitled "Mortgage Financing: Rights of Mortgage Holders." *Id.* at 701, 587 A.2d at 1183. This section of the agreement permitted financing through a mortgage or lien on the property, but only to the extent that the funds were used for improvements to that particular property, while not exceeding the purchase price. *Id.* at 703, 587 A.2d at 1184.
50. *Id.* at 703, 587 A.2d at 1185 (finding insufficient evidence to determine whether the loan was authorized under the agreement).
51. *See id.* at 700, 587 A.2d at 1183 ("[T]he mortgage terminated when the City re-entered the property and title revested in it."). Scrutton v. County of Sacramento, 79 Cal. Rptr. 872 (Cal. Ct. App. 1969), provides an interesting analogy contrast to the court's decision in *Walker*. In *Scrutton*, a landowner appealed a conditional rezoning of her property. *Id.* at 875. While the court upheld the rezoning as within the police power, it struck down a reversion clause within the rezoning amendment. *Id.* at 878-79. The court held that such a clause would in fact constitute a second rezoning, which was procedurally and substantively invalid. *Id.* The zoning reversionary clause at issue in *Scrutton* is analogous to the right of reentry under the *Walker* agreement. Thus these two cases represent inapposite results that could impact on the enforceability of the development agreement and its attendant consequences for a lender.
52. *Walker*, 86 Md. App. at 697-700, 587 A.2d at 1182-83 (discussing impact of development agreement as extinguishing defeasible estate following breach of conditions).
53. *See* Fitzgerald & Peiser, *supra* note 31, at 41-45 (analyzing complex development agreement, corresponding pitfalls, and delays, including subsequent renegotiation of agreement); *see also infra* notes 229-44 and accompanying text (discussing remedies associated with breach of development agreement).

III. FINANCING REAL ESTATE DEVELOPMENT

Real estate development proceeds through a series of phases, each with its own corresponding financing component.[54] The development process may be undertaken and completed by one developer or, in the alternative, different developers may assume responsibility for each particular component.[55] The initial stage of development is land acquisition. The developer most often finances this through a first-mortgage land loan secured by the property acquired.[56] Following land acquisition, the developer usually seeks funding for both land development and construction.[57] Finally, upon completion of the development, the developer will attempt to obtain permanent or "takeout" financing.[58] This next section provides an overview of the real estate financing process. It attempts to identify the key concerns of lenders as they evaluate a loan application for a development project. The potential success of the project is of utmost importance to the developer because it is this success that will form the basis for repayment of the loan. This overview identifies and discusses key aspects of the financing process potentially implicated, or carrying consequences for, the negotiations of a development agreement.

A. *Land Development and Construction Financing*

Construction and land development financing represent the interim stage of the development financing process.[59] The construction

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54. RICHARD HARRIS, CONSTRUCTION AND DEVELOPMENT FINANCING, at v (1st ed. 1982).
55. *Id.*
56. ARNOLD, *supra* note 5, ¶¶ 1.01, 1.06. Additional methods of funding land acquisition include financing by the seller, *id.* ¶ 1.08, and installment land-purchase contracts, *id.* ¶ 1.09. Traditionally, financing is obtained from institutional lenders such as commercial banks, savings and loan associations, and mortgage bankers. *Id.* ¶ 1.10. Because of problems associated with the valuation of raw acreage, which is usually the subject of the initial land acquisition financing, the modern trend is towards combining land acquisition financing with development and construction financing in a project financing package. *Id.* ¶ 1.05; *see also id.* ¶ 4.08 (discussing advantages, disadvantages, and structuring of project financing). *See generally* David E. Grogan, *Acquisition, Development, and Construction Loans: Some Implications of Equity Financing,* 73 VA. L. REV. 243 (1987) (evaluating accounting, regulatory, and lender-liability implications of ADC loans).
57. HARRIS, *supra* note 54, at vii-x.
58. HARRIS, *supra* note 54, at viii. Takeout or permanent financing is generally a long term loan that is used to repay the construction loan and to act as long term financing for the project. ARNOLD, *supra* note 5, ¶ 5.01. For a comprehensive discussion of the nature, structure and role of permanent financing, see *id.* ¶¶ 5.03-5.04.
59. ARNOLD, *supra* note 5, ¶¶ 2.01, 3.01, 5.01. Such financing is primarily of short or intermediate length, and is eventually "taken out" by permanent financing. *Id.*; *see also supra* notes 54, 58 and accompanying text.

and land development phases are actually two separable components in the essential stage of turning raw acreage into developed and usable property.[60] Development agreements are integrally linked to the construction of a particular project. This section examines the financing concerns implicated in this stage of real estate development.

1. Land Development Financing

Land development encompasses the legal,[61] engineering,[62] and physical processes[63] that render raw acreage into land which is ready for construction. None of these processes are likely to create a vested right in the proposed project.[64] It is at this stage, however, that the developer would enter into development agreement negotiations with a municipality and thereby obtain an early vested right. Financing for land development is usually secured by the property to be developed.[65] A number of factors are important to a lender in evaluating a land development loan application, including valuation of the property,[66] protection from mechanic's liens,[67] and subordination of any prior encumbrances, primarily the land acquisition loan.[68] The lender must also ensure itself that, in the event of borrower default, it can obtain rights to any land use approvals or permits that have been issued to the developer.[69]

Another concern to the land development lender is the existence of subdivision regulations. Subdivision regulations are similar to development agreements in that local governments utilize these re-

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60. ARNOLD, *supra* note 5, ¶ 2.01[1].
61. Legal prerequisites to the commencement of construction include the completion of annexation, the ascertainment of zoning status, and procurement of any necessary exceptions or permits. *Id.*
62. The land development engineering processes encompass surveying, subdivision (platting), and planning of general layout prior to the start up of construction. *Id.*
63. A number of physical improvements will have to be undertaken prior to construction, including installation of requisite infrastructure, grading, and landscaping. *Id.*
64. *See, e.g.*, Gosselin v. Nashia, 321 A.2d 593 (N.H. 1974) (examining expenditures on architectural and engineering services, and finding no vested right); Smith v. Juillerat, 119 N.E.2d 611 (Ohio 1954).
65. HARRIS, *supra* note 54, ¶ 2.2.
66. ARNOLD, *supra* note 5, ¶ 2.02[1] (indicating that at land development stage it is still difficult to value property following improvements).
67. *Id.* ¶¶ 2.02[1][b], 2.02[2][b] (discussing entitlement of professionals and contractors, employed to carry out completion of development stage, to protection of mechanic's liens).
68. *Id.* ¶ 2.02[4].
69. *Id.* ¶ 2.02[3] ("Carefully drafted land development loan documents will require an assignment by the borrower of its rights in all governmental applications. . . .").

gulations to impose exactions on the developer.[70] The financing needs of the developer, therefore, will include expenses necessitated by the regulations' requirements.[71] One method often used to ensure completion of the exaction requirements, as well as protect the interests of the developer, lender, and municipality, is the use of a subdivision improvement agreement.[72] This agreement may provide for notice to the lender upon the developer's failure to comply with the terms and requirements of the regulatory exaction.[73] Furthermore, it may provide the lender with an opportunity to rectify such default.[74] The subdivision improvement agreement helps ensure performance to the municipality while protecting the different parties' rights and expressly providing remedies in the case of default, thereby lowering the risk to lenders posed by subdivision regulations.[75]

2. Construction Loans

A construction loan is a "loan made on the security of a real estate mortgage, the proceeds of which are disbursed gradually to pay the cost of construction and other improvement to the real estate as construction progresses."[76] Construction loans carry a high degree of risk,[77] namely that the developer will be unable to complete the

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70. *Compare* Frona M. Powell, *Challenging Authority For Municipal Subdivision Exactions: The Ultra Vires Attack*, 39 DePaul L. Rev. 635 (1990) (tracing history of subdivision exactions and arguing for broad construction of state enabling legislation to encompass such actions by local government) *with* Cowart, *supra* note 11, at 29-32 (concluding that over 50% of development agreements impose some type of exaction on developer).
71. *See* Arnold, *supra* note 5, ¶ 2.03 (examining implications for lender of exactions imposed by subdivision ordinances and concluding such expenses constitute part of project cost); *see also supra* note 10 and accompanying text (discussing who ultimately bears increased costs associated with exactions).
72. Arnold, *supra* note 5, ¶ 2.04[5]. Alternative methods of insuring developer performance of exaction requirements include surety bonds, *id.* ¶ 2.04[1]; use of cash deposits or escrows, *id.* ¶ 2.04[2]; property escrows, *id.* ¶ 2.04[3]; and letters of credit, *id.* ¶ 2.04[4].
73. *Id.* ¶ 2.04[5], form 2.1. Subdivision improvement agreements are not common, but they provide several advantages over traditional guarantees utilized in the subdivision exactions process. *Id.* Their primary advantages are related to their flexibility in design, as well as their ability to protect the lender from cost overruns or diversion of funds. *Id.*
74. *Id.* ¶ 2.04[5], form 2.1 ("Should any Event of Default occur, lender may at its option, undertake to cure such Event of Default.").
75. *Id.* ¶ 2.04[5]; *see also id.* ¶ 2.04[5], form 2.1 (providing exemplary subdivision improvement agreement that allows lender or municipality opportunity to cure default, or in the alternative, permitting lender to halt disbursement of funds upon breach by municipality or developer).
76. *Id.* ¶ 3.01[1].
77. *See id.* ¶ 3.02 (delineating business and legal risks associated with construction loans as: use of land and buildings under construction as security; unforeseeable risks associated with construction, such as labor difficulties; intervening liens

proposed development.[78] Because of the risks associated with construction financing, the loan approval process tends to be both long and assiduous,[79] generating a complex, detailed loan agreement.[80] The construction lender will attempt to ensure the security of its loan by requiring, prior to lending any funds, a letter that provides for takeout or permanent financing.[81] It has become increasingly apparent, however, that these commitments often provide inadequate protection.[82]

The potential repercussions of a default under the construction loan are substantial from the lender's perspective: the value of the loan and securing collateral is predicated upon completion of construction.[83] In the event of default, the lender, in an effort to minimize

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and rights of third parties; zoning and building requirements; potential loss of permanent financing; and improper or poor marketing of finished project); *see also* JAMES H. BOYKIN, FINANCING REAL ESTATE 325-26 (1979) (outlining major risks attendant to construction financing as failure of developer to complete proposed development; potential for intervening or outstanding liens on property to undermine collateral value; poor marketing analysis rendering project unattractive to proposed end user; and inadequate funding for completion of project).

78. The implication of these risks is that the property that secures the mortgage is the land and proposed buildings. Thus, the commencement and subsequent failure to complete construction may reduce the value of the property. ARNOLD *supra* note 5, ¶¶ 2.02, 3.02[2].

79. *See, e.g., id.* ¶¶ 3.03, 3.05 (discussing evaluation and financial analysis associated with determination of project feasibility); *Construction Lending*, CREATIVE REAL EST. FIN. 583, 585-88 (1989) (providing checklist of concerns associated with entering into a construction loan, including ability and experience of developer, as well as financial status and value of proposed development); BOYKIN, *supra* note 77, at 329-30 (indicating that proposed mortgagee will carefully scrutinize financial status of developer and project prior to loan commitment).

80. *See* BOYKIN, *supra* note 77, at 332 (detailing rights and obligations to be delineated within construction loan agreement); *see also* ARNOLD, *supra* note 5, ¶ 4.06 (viewing construction loan agreement as contract that regulates and protects rights and obligations of borrowers, as well as providing outline of contents to be included in agreement). Lenders also attempt to limit the risks associated with construction financing by delineating the terms and conditions associated with the loan through the use of a commitment letter. ARNOLD, *supra* note 5, ¶ 4.06 (stating that the commitment letter acts as binding contract between borrower and lender).

81. *See* ARNOLD, *supra* note 5, ¶¶ 3.03[3], 5.01 (discussing role of permanent financing commitment as security for construction loan, but indicating that function may be more illusory than real). Other methods of assurance may be required by the lender prior to entering into a loan commitment. *See, e.g., id.* ¶ 4.16 (construction loan guarantees); *id.* ¶ 4.17 (performance and payment bonds); *id.* ¶ 4.19 (hazard and liability insurance).

82. *See id.* ¶ 5.01 ("[C]onstruction loan default by the borrower owing to some misfortune or delay during the construction process will probably relieve the lender from its obligation under the terms of its commitment.").

83. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 12.1 (2d ed. 1985). *See* ARNOLD, *supra* note 5, ¶¶ 3.02[1], 6.01 (indicating that land with partially constructed fixture is worth less than vacant property).

its exposure, will pursue a course of action that will permit the completion of construction.[84] A variety of factors will impact upon the lender's ability to complete construction.[85] Among these factors is the threat posed by a change in the local government land use scheme, which potentially could undermine the development of the property[86] and may be the cause of the default in the first place by rendering development infeasible.[87] Thus, the stability of the applicable land use scheme will be of great concern to the lender.

It is the premise of this Article that development agreements, if properly structured, act to limit the risks associated both during the construction process and on default by freezing the land use scheme which would vest a right in development in the developer or potentially the lender.

B. *Real Estate Component Financing*

Traditionally, real estate loans were secured by a mortgage on the fee simple estate; however, this is less true today.[88] Rather, a

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84. ARNOLD, *supra* note 5, ¶ 3.02[1]; *see id.* ¶ 6.03[1] (finding that all lender action, following default, is aimed at achieving completion of construction in order to avoid material impairment of value of collateral).

85. Depending on the course pursued by the lender, contracts, permits, leases, and takeout commitments may impact on the lender's ability to complete construction in the planned and profitable manner. *See supra* notes 15, 81-82 and *infra* notes 86, 89, 117-35 and accompanying text (discussing advantages and disadvantages to lender in pursuing different courses of action following borrower default). Furthermore, the lender will face the same risks that are posed to the developer. *See supra* note 77 and accompanying text (identifying risks involved in construction process). Finally, by becoming involved in the construction process the lender opens itself up to a variety of liabilities. *See* ARNOLD, *supra* note 5, ¶ 6.06[4]; *see also supra* notes 5-6 and accompanying text (outlining potential lender liability as "owner or operator" under CERCLA).

86. *See* ARNOLD, *supra* note 5, ¶ 3.04 (indicating that delay in completion of construction may render completion impracticable because of rezoning, and further indicating that partially completed structure may constitute nuisance subject to condemnation); *Id.* ¶ 2.02 (suggesting that properly drafted loan agreement will include provision for assignment of borrower's rights in governmental permits to lender in case of default as protection of lender's security interest); *see also supra* notes 31-40 and accompanying text (illustrating problems posed by changing land use regulatory scheme on real estate development process).

87. *See supra* notes 32-39 and accompanying text (reviewing Avco Community Developers, Inc. v. South Coast Regional Comm'n, 553 P.2d 546 (Cal. 1976), *cert. denied*, 429 U.S. 1083 (1977), where court held that failure to comply with regulation or receive valid waiver would bar developer from completing project).

88. *See* NELSON & WHITMAN, *supra* note 83, § 1.2 (exploring historical evolution of mortgage from Anglo-Saxon practice of fee simple conveyance, subject to a condition subsequent, to present day mortgage law); *see also* Richard J.

mortgage may attach to *any* real property interest, including a leasehold estate.[89] To the extent that a development agreement constitutes a real property interest and is used as security in the financing process, it resembles component financing.[90] This section provides a brief overview of the financing of various real estate interests or components with a particular focus on a mortgage attaching to a leasehold interest.

Real estate components may be either physical[91] or legal[92] in nature. The underlying problem that confronts a lender and developer in attempting to mortgage a particular component of a larger estate is the need to ensure that the component may be alienated and used separately from the larger estate.[93] An examination of lender concerns pertinent to leasehold mortgages illustrates many of the considerations and problems associated with real estate component financing.

1. Leasehold Financing

Leasehold mortgages, or financing secured by some type of long term lease,[94] are a type of financing provided to the developer-lessee

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Kane, *Introduction*, CREATIVE REAL EST. FIN. 11, 15 (1991) (indicating that creation of "layered estates" and corresponding development rights in real property is one factor leading to increased complexity in real estate financing); Robert A. Thompson, *Financing of Real Estate Components*, CREATIVE REAL EST. FIN. 561 (1991) (outlining concerns related to financing secured by property interest that constitutes less than fee simple).

89. STUART M. SAFT, COMMERCIAL REAL EST. TRANSACTIONS, § 9.44 (1989) ("A *mortgage* or *deed of trust* is any written instrument creating a lien on real property."). *See* WILLIAM ATTEBERRY, MODERN REAL EST. FIN. 1 (1976) (delineating mortgageable interest as inclusive of "rental income, dower interest, estate for years or leaseholds, in addition to fee ownership"); Steven R. Davidson, *Leasehold Financing: The Lender's Evaluation of a Tenant's or Landlord's Interest in a Lease*, CREATIVE REAL EST. FIN. 567 (1991) (discussing concerns attendant to financing of leasehold estate).

90. *See supra* note 24 and *infra* notes 232-40, 251 and accompanying text (positing that development agreement conveys property right in development as discrete property interest).

91. William R. Theiss, *Financing of Real Estate Components*, CREATIVE REAL EST. FIN. 565, 567-72 (1990) (citing air and mineral rights as examples of physical components). Furthermore, the physical component may consist of a horizontal section of the development. *Id.* at 567 (citing one part of phased development as example).

92. *Id.* (citing leasehold interest or interest of co-tenant as examples of legal components).

93. *Id.* ("[R]egardless of what type of component financing is used [there] is, the necessity to provide for sufficient rights so that each component, whether physical or legal, can be owned, transferred, and used independently of the other components.").

94. Davidson, *supra* note 89, at 569. Such financing may consist of either a ground lease or a long term lease of improvements. *Id.* at 569 n.1; *see* ARNOLD, *supra*

for the construction of buildings or improvements.[95] The use of the lease as the collateral for the loan can lead to two outcomes that will be of great concern to the lender. First, an act of the lessor can terminate the lease, eliminating the security for the loan.[96] Second, the developer-lessee may default under the loan agreement, thus placing the lender in the position of the lessee, and thereby subjecting the lender to the terms of the lease.[97] To address concerns posed by either of these alternative outcomes, the lender, in determining whether to extend financing to the lessee, will carefully scrutinize the terms of the lease that secures the loan.[98]

Because the terms of the lease are essential in determining the availability of financing, the lessor and lessee must design the lease in a manner that renders it financeable.[99] Ideally, the parties should consult the lender during the negotiation process.[100] Terms that deserve specific consideration include the duration of the lease,[101] title assurances through subordination agreements,[102] conditions pertaining to the alienability or assignability of the leasehold,[103] provisions

note 5, ¶ 7.02 (differentiating between mortgage secured by long term leasehold estate and mortgage secured by fee title based on subordination of fee to mortgage lien).

95. ARNOLD, *supra* note 5, ¶ 7.02 (indicating that such improvements include department stores, shopping centers, and "satellite stores").

96. Davidson, *supra* note 89, at 569. The leasehold estate, created by the lease, serves as the collateral for the loan. Thus, a termination of the lease destroys the corresponding estate. *Id.* Similarly, the occurrence of a condition subsequent terminates a defeasible estate and may have an analogous effect on a lender's security interest. *See supra* notes 42-53 and accompanying text (discussing effect of development agreement creating defeasible estate upon mortgagee's interest).

97. Davidson, *supra* note 89, at 570.

98. *Id.*

99. *See id.* at 571-72 (indicating that structuring lease may be problematic because of attempts to negotiate with presence of "phantom" third party lender).

100. *Id.* at 572 (acknowledging that this is often impossible because financing has not yet been sought at time of lease drafting, or because of potential involvement of subsequent lenders based on changing need of project).

101. *Id.* at 572-74. The duration of the lease impacts on its value as security because the shorter the term the less likely that any party will be willing to assume it. *Id.* Related to examining the duration of the lease, will be a review of any provision governing its renewability, which will impact on its value to the lender. *Id.*

102. *Id.* at 575-76, 583-84 (identifying need to ensure priority of leasehold mortgage over mortgage secured by fee because alternative is that default of fee mortgage would extinguish leasehold security; and indicating that this may be accomplished through a non-disturbance and subordination agreement). Under a non-disturbance agreement, the fee mortgagee agrees to recognize the leasehold estate in the event of its assumption of the underlying fee. *Id.* at 575. Such an agreement is voidable, however, in the event of bankruptcy proceedings; thus, a subordination provision may be required. *Id.*

103. *Id.* at 576-79. "Most often, however, the leasehold mortgagee will not be

regulating default and corresponding remedies,[104] operating covenants,[105] and specifications regarding disposition of condemnation or insurance proceeds.[106]

2. Assignment of Rents as Collateral

In the alternative, a lease may enable a developer-lessor to secure financing for improvements or construction on the fee simple.[107] A lender may accept an assignment of the flow of income from rents as part of the collateral or security underlying the financing.[108] Rent represents a "sure" source of cash flow that can be used to service the mortgage debt.[109] While an assignment of rents as part of the security for a loan does not pose the dangers that leasehold financing does, it still poses a number of risks and considerations that the lender will wish to address prior to committing to financing.[110]

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satisfied unless there are no restrictions on subsequent transfers of a tenant's interest in the ground lease since restrictions will affect the marketability and therefore the value of that interest." *Id.* Assignability is of particular importance because without it the lender will have no way of succeeding to its security interest in the event of borrower default. *Id.* at 572. Furthermore, such assignability may be essential to the ultimate realization of profit from the proposed construction. *See id.* at 579 (indicating that motivation behind improvement is ultimate sublet to commercial tenant).

104. *Id.* at 579-81 (indicating that financeable lease will provide for notice and opportunity to cleanse defect by lender in case of borrower default under terms of lease; and further exploring utilization of "new lease" provision that allows mortgagee to enter into new lease in event of borrower default under initial lease).

105. *Id.* at 585-87. Operating covenants are those that regulate the use of the leasehold estate. *Id.* at 585 (noting that lender may require exemption from stringent operating covenants in event of succession to lease because such conditions may render it infeasible to utilize leasehold in valuable manner).

106. *Id.* at 581-82 (requiring participation right to condemnation or insurance proceeds in event that lease is rendered unusable).

107. Davidson, *supra* note 89, at 569-70. *See, e.g.,* Harry B. Hyde, *The Real Estate Lease as a Credit Instrument From the Lender's Viewpoint*, COM. REAL EST. LEASES 153 (1988) (examining use of leases as credit instruments in ensuring mortgagor's ability to service debt based on proceeds generated by rents); Brian J. Strum, *The Mortgagee Looks At the Lease As a Basis For Mortgage Financing*, COM. REAL EST. LEASES 267 (1991) (identifying use of income produced by leases as method of appraising value of property and exploring lenders' concerns related to such financing); Caryl B. Welborn, *An Analysis of Commercial Space Leases from the Perspective of a Secured Lender*, COM. REAL EST. LEASES 21 (1991) (outlining purpose and scope of lender analysis and specifically addressing issues related to nondisturbance and attornment agreements in insuring flow of income from leases to service debt).

108. *See* Hyde, *supra* note 107, at 155 (indicating that use of lease as credit instruments arises from lender's desire to ensure secured and fixed rate of return on investment).

109. *Id.*

110. *See id.* at 156-57 (identifying lender concerns in lease as related to tenant's

As with leasehold financing, a lender will approach the lease from two perspectives.[111] First, because the lease represents the terms that determine the flow of income through rent, the lender will be concerned with provisions that disrupt this cash flow, potentially disrupting the borrower's ability to service the debt.[112] This includes, among other things, the financial status of the tenant.[113] Second, as is the case of leasehold financing, the lender will be concerned with the possibility that, upon default by the borrower, it will step into the lessor's shoes.[114] The lender will focus on the terms of the lease that would define its duties and rights as a landlord.[115] These are the same terms implicated in leasehold financing.[116]

C. *Borrower Default, Remedies, and Subordination*

There are three principal options open to a mortgagee upon default by the borrower:[117] foreclosure of the mortgage, a deed in

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credit and provisions governing landlord-tenant relationship as well as mortgagee's ability to enforce lease and succeed to lessor position); *see also* Davidson, *supra* note 89, at 569-70 (stating that while use of cash flow generated by leases as additional security does not leave lender open to extinguishment of security interest, it may still pose substantial pitfalls to lender).

111. *See supra* notes 89, 96, 104, 106 and *infra* notes 112, 116 and accompanying text (delineating lender concerns related to interruption of income from rents, as well as potential succession into shoes of lessor resulting from borrower default); *cf. supra* notes 89, 96, 104, 106 and *infra* notes 112, 116 and accompanying text (identifying concerns of lender involved in leasehold financing as potential destruction of security interest, as well as succession to role of lessee, in event of borrower default).
112. *See* Davidson, *supra* note 89, at 591 (indicating that lender, in reviewing lease and corresponding income stream as source of collateral, will be concerned with provisions in lease that might provide for termination, reductions or offsets of rents, and other costly obligations to the lender).
113. Hyde, *supra* note 107, at 156 (stating that in assessing credit support provided by lease, lender will look at tenant's credit rating, amount of rent, length of lease and potential volume of business generated by tenant).
114. Davidson, *supra* note 89, at 591.
115. *Id.*
116. *See id.* (delineating provisions pertaining to duration, operating covenants, subordination, insurance and condemnation proceeds, and lease assignability as key concerns of mortgagee). Attornment and nondisturbance provisions will be essential in providing assurance to the lender, that in the event of borrower default, the leases and corresponding income stream will continue in effect. *See* Welborn, *supra* note 107, at 26-32 (providing model subordination, nondisturbance and attornment agreement).
117. Default under the terms of the mortgage may occur in a number of different ways. *See* ARNOLD, *supra* note 5, ¶ 6.02 (dividing danger signs indicating default of construction mortgage into two distinct categories: nonpayment and nonmonetary events); *see also* ATTEBERRY, *supra* note 89, at 31 (indicating that mortgage default may also occur through failure to pay taxes or insurance

lieu of foreclosure, or a real estate workout.[118] There are advantages and disadvantages associated with each of these alternatives.[119] This section will provide a brief overview of these advantages and disadvantages.

Foreclosure is the traditional response to the borrower's default under the mortgage agreement.[120] Foreclosure provides the lender with either title to the property or rights of possession.[121] In addition, it eliminates junior liens on the property, allowing the borrower to take title free and clear.[122] Foreclosure, however, has a number of

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premiums, or through breach of covenants in mortgage instrument). Some of the events that indicate a developer is in default include a situation where construction costs exceed amount of loan outstanding, indicating that project may be in jeopardy; construction delay that may result in a number of problems, precipitating default; diversion of loan proceeds to projects other than the one being financed; and developer bankruptcy. ARNOLD, *supra* note 5, ¶ 6.02. The risk associated with developer bankruptcy is particularly ominous in financing secured by a leasehold estate because this constitutes an executory contract and thus is within the power of the trustee to reject. 11 U.S.C. § 365 (1988). For a general exploration of the risk posed to a mortgagee's security interest, by application of § 365 to a lessor, see William E. Winfield, *Rejection of Nonresidential Leases of Real Property in Bankruptcy: What Happens to the Mortgagee's Security Interest?*, 17 PEPP. L. REV. 429 (1990).

118. *See generally* ARNOLD, *supra* note 5, ¶¶ 6.04-6.07 (outlining advantages and disadvantages associated with different lender remedies in event of borrower default). In addition to these three common methods, the mortgagee may have other options available to recover its loan. *See id.* ¶ 6.08 (identifying loan guarantee as potential source of recovery, but indicating that in construction loans such guarantees are more illusory than real).

119. *See supra* notes 15, 82, 86, 89, 117 and *infra* note 135 and accompanying text (exploring advantages and disadvantages associated with foreclosure, deeds in lieu of transactions, and workouts, and concluding that workouts are generally the most appropriate remedy in construction loan context).

120. *See* ATTEBERRY, *supra* note 89, at 31-36 (providing historical overview of mechanisms for dealing with borrower default, including comprehensive chart detailing methods of foreclosure on state by state basis); *see also* ARNOLD, *supra* note 5, ¶ 6.04 (indicating that while the most obvious remedy for borrower default is foreclosure, it may not be the most appropriate remedy in a construction loan context). Foreclosure may take a number of forms: strict foreclosure, judicial foreclosure, or power of sale foreclosure. *See generally* NELSON & WHITMAN, *supra* note 83, §§ 7.9-7.30 (detailing different types of foreclosure and corresponding requirements).

121. *See* ARNOLD, *supra* note 5, ¶ 6.04 (indicating that among chief advantages of foreclosure is ability of lender to either take title and subsequently sell property, or entitling lender to possession, thus enabling it to complete construction). *See also* NELSON & WHITMAN, *supra* note 83, §§ 4.24-4.32 (exploring "mortgagee in possession" rule and indicating that in many jurisdictions mortgagee is entitled to possession of collateral property in event of borrower default).

122. ARNOLD, *supra* note 5, ¶ 6.04; *cf. id.* ¶ 6.04[2] (indicating that elimination of junior liens may not be an easy process and delineating defenses available to such lien holders including assertion of equitable lien status, estoppel, and usury).

disadvantages, including expense and delay.[123] In the case of land development and construction financing, foreclosure may also terminate contracts and obligations associated with the development, as well as a takeout commitment.[124] This could potentially extend to an ill-drafted development agreement. All of these potential problems increase the risk to the mortgagee that the proceeds from the sale of the collateral will be insufficient to recoup enough money to satisfy the outstanding loan.[125]

A deed in lieu of foreclosure is often a lender's preferred course of action when faced with default on a land development or construction loan.[126] Many of the disadvantages associated with traditional foreclosure are not presented by deed in lieu of foreclosure transactions.[127] Deeds in lieu of foreclosure, however, pose other problems.[128] One potential problem is judicial construction of the deed in lieu of foreclosure as an equitable mortgage. This returns the mortgagee to its original position and will require that the lender bring a subsequent foreclosure action imposing the aforementioned costs and delays of foreclosures.[129] Furthermore, in the event of

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123. NELSON & WHITMAN, *supra* note 83, § 7.11. *See generally* ARNOLD, *supra* note 5, ¶ 6.04 (delineating disadvantages associated with foreclosure as expense, delay, adverse publicity, and loss of continuity of work, as well as fact that foreclosure often fails to result in loan repayment).

124. ARNOLD, *supra* note 5, ¶ 6.04. In the case of construction loans, it is in the lender's best interest for the project to be completed. *Id.* ¶ 6.03[1]. Foreclosure may substantially delay, as well as add cost to this process. *Id.* ¶ 6.04. This is particularly true because often the defaulting developer is the best man to complete the project. *Id.* ¶ 6.04.

125. *Id.*; *see supra* notes 77-78, 83-87 and accompanying text (discussing interrelationship between completion of construction and value of property securing loan).

126. ARNOLD, *supra* note 5, ¶ 6.05. A deed in lieu of foreclosure occurs where the mortgagor delivers title to the mortgaged premises in consideration for cancellation of the mortgage debt. NELSON & WHITMAN, *supra* note 83, § 6.18.

127. *See* ARNOLD, *supra* note 5, ¶ 6.05[2] (indicating that deed in lieu of foreclosure is generally inexpensive, and nonpublic, in direct contrast to high cost and adverse publicity often associated with foreclosure).

128. *See* NELSON & WHITMAN, *supra* note 83, § 6.19 (contrasting simplicity of deed in lieu of foreclosure as recovery mechanism, with potentially complex and problematic results). *See generally* ARNOLD, supra note 5, ¶ 6.05[2] (identifying disadvantages inherent in deeds in lieu of foreclosure as required concessions to borrower; potential construction as equitable mortgage; and potential for merger resulting in subordination of lender's interest to those of junior lien holders). A major problem may be the negotiation of terms governing the deed in lieu of foreclosure, because the lender's interest will be in direct conflict with that of the borrower. *Id.* ¶ 6.05[3].

129. ARNOLD, *supra* note 5, ¶ 6.05[2][b]. *See* NELSON & WHITMAN, *supra* note 83, § 3.4 (discussing historical evolution of equitable mortgage from practice of utilizing two separate documents to affect a condition of defeasance on an estate); *id.* § 6.19 (indicating that a court may construe deed in lieu of

bankruptcy, a substantial possibility exists that the deed in lieu of foreclosure will be set aside as a fraudulent conveyance.[130] Careful drafting of the deed, however, may serve to limit either of these scenarios, rendering this a satisfactory alternative to foreclosure.[131]

Finally, real estate workouts have gained increasing popularity as a mechanism for dealing with the threatened default of real estate development loans.[132] Because the value of the collateral securing a real estate development loan is often contingent upon the development's completion, it may be in the lender's interest to negotiate an arrangement with the developer that will ensure completion of the project.[133] The lender and developer accomplish this through a renegotiation of some of the terms of the original loan, enabling the developer to successfully complete construction.[134] Real estate wor-

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foreclosure as separate mortgage transaction, as opposed to conveyance by absolute deed).

130. ARNOLD, *supra* note 5, ¶ 6.05[2][d]. For a general discussion of the effect of bankruptcy on a mortgagee's interest, see NELSON & WHITMAN, *supra* note 83, §§ 8.12-8.17. "[T]ransfers made by debtor within one year of bankruptcy may be set aside by the trustee if they were made with the intent to hinder, delay or defraud any creditor." NELSON & WHITMAN, *supra* note 83, § 8.13

131. *See* SAFT, *supra* note 89, § 6.46 (discussing trend towards restructuring defaulted mortgage as response to increasing inability of foreclosure to serve as method of repaying loan, and indicating that underlying rationale is ability to further completion of construction as well as avoid adverse publicity that might ultimately impact on value of project).

132. *See* ARNOLD, *supra* note 5, ¶ 6.06 (indicating that foreclosure or deed in lieu of foreclosure places lender in developer's shoes, subjecting it to corresponding obligations and liabilities that are not in lender's best interest; also indicating that workout may serve as most effective solution for completion of construction).

133. *See supra* notes 78, 83 and accompanying text (concluding that value of security is inherently linked to completion of proposed project). In addition, the lender may pursue a workout, subsequent to foreclosure, by entering into a workout arrangement with a new developer. *See* ARNOLD, *supra* note 5, ¶ 6.07 (exploring lender's options in event of succession through foreclosure or deed in lieu of foreclosure to property with partially completed construction and indicating that because of inability of lender to act as real estate developer, the lender may choose to complete project by entering into an arrangement with a "new borrower"). The other option that is open to a developer, is a quick sale of the incomplete project. This sale, however, may result in a loss on the loan. *Id.* ¶ 6.07.

134. *See* ARNOLD, *supra* note 5, ¶ 6.06[1] (stating that effective real estate workout with developer may require concessions from lender, including loan extension, interest adjustments and continued, additional funding). Despite the need to agree to certain terms that will enable and encourage the developer to stay involved with, and complete the project, a workout agreement may contain provisions that enhance a lender's position in the project. *Id.* ¶ 6.06[2]. Thus, the lender may take more active control of the direction and management of the project, may require additional collateral, or may be able to subordinate the future profits of the development in order to insure a dedicated source of

kouts are cheaper and more efficient than foreclosure and they eliminate many of the construction problems associated with deeds in lieu of foreclosure. They also allow the developer to complete the project and thus enable the lender to recoup more of its investment.[135]

This section has attempted to delineate some of the key concerns and issues involved in real estate development financing. Focusing on real estate component financing, it indicates that the mortgagee is primarily concerned with ensuring and maintaining the value of its collateral. The priority of the mortgagee in construction financing is the completion of the proposed project. To this end the mortgagee will seek to do everything in its power to structure the agreement so as to protect its interest and ensure completion of the project.

IV. DEVELOPMENT AGREEMENTS

As local governments have developed increasingly complex land use regulations,[136] growing uncertainty has confronted real estate developers in the development process.[137] In an effort to inject some degree of certainty into real estate development, as well as to provide a framework for public-private coordination of the development process, local governments have turned increasingly to the use of

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repayment of the loan. *See id.* (enumerating these potential enhancements to lender's position, as well as potential for requiring additional guarantees, and, perhaps most importantly, a clause that provides for automatic reversion of the property to lender in the event of workout default).

135. *Id.* ¶ 6.06[2]. While there are numerous advantages associated with the real estate workout process, the process also poses a number of disadvantages. In negotiating a real estate workout arrangement, it is important to take into consideration the positions of junior lien holders. *Id.* ¶ 6.06[4][b]. Additionally, workouts raise the potential application of the obligatory advance rule that may undermine the priority of the lender's interest. *Id.* ¶ 6.06[4][c]. Perhaps most importantly, the lender's increased involvement in the real estate development process may increase its exposure to liability associated with the development. *Id.* ¶ 6.06[4][b]. *See also supra* notes 5-6 and accompanying text (discussing lender liability under environmental law and common law tort principles).

136. Traditional land use regulations take a variety of forms ranging from zoning ordinances, subdivision regulations, and the establishment of master plans. Hershman, *supra* note 20, pt. 1 at 11 (providing historical overview of land use controls and describing increasing complexity associated with land use as well as impact on conveyancing practices).

137. *See* Marsh, *supra* note 13, at 3 (stating that following the 1960s, there has been increased exercise of public authority over development through zoning changes and exactions that has unstabilized development market, particularly in area of large-scale projects requiring infrastructure investments); Fry, *supra* note 12, at 483-84 (stating that the complex development process and questions related to vesting of development rights serve to deter real estate development).

development agreements.[138] Development agreements are essentially bilateral contracts between a municipality and real estate developer.[139] Unlike contract or conditional zoning,[140] which may be judicially suspect, development agreements are contracts made independent of any type of rezoning. Their intent is not to change the applicable zoning scheme, but rather is a promise by the municipality to freeze the applicable land use regulatory scheme in return for specified performances by the developer.[141] Thus, a development agreement implicitly conveys a vested right in development,[142] going further than

138. *See* Fry, *supra* note 12, at 484; Kessler, *supra* note 27, at 452. *See also* Callies & Grant, *supra* note 10, at 241 (finding that a 1986 survey of over 450 California cities and counties indicated that 150 were using development agreements, with 300 agreements in place and 150 being negotiated, and 100 additional communities expressing interest in utilizing such agreements). For an article comprehensively reviewing this 1986 survey see Cowart, *supra* note 11, at 9-29 (reviewing data and concluding that California has moved rapidly to implement development agreements since enactment of enabling legislation in 1979).

139. *See* Fry, *supra* note 12, at 484 (stating that development agreements are bilateral contracts that are mutually enforceable and provide mutual advantages to both developer and municipality); Callies & Grant, *supra* note 10, at 239 (indicating that development agreements act as a contract between local government and private property holder based on bilateral covenants, thus providing greater certainty to developers). *See also infra* notes 142, 145, 179 and accompanying text (discussing vested rights doctrine).

140. Contract zoning consists of a unilateral covenant, which places the sole burden on the developer. Callies & Grant, *supra* note 10, at 240. *But see* Wegner, *supra* note 24, at 981 (concluding that, in fact, "contract zoning" involves no exchange of consideration and thus is more regulatory than contractual in nature).

141. Callies & Grant, *supra* note 10, at 240. *See* Theodore C. Taub, *Development Agreements*, A.L.I.—A.B.A. LAND USE INST. 555, 558 (1991) [hereinafter Taub, *Development Agreements*] (indicating mutual benefits resulting to both developer and local government from development agreements). The use of bilateral promises, placing a burden and bestowing a benefit on both parties of the agreement provides sufficient consideration to validate the agreement. Callies & Grant, *supra* note 10, at 240. Thus development agreements are distinguishable from contract zoning, which is normally held invalid. *Id. But see* Wegner, *supra* note 24, at 979 n.122 (indicating that courts generally hold unilateral contracts valid, as opposed to bilateral contracts as invalid, but concluding that a distinction is problematic and essentially a labeling game by the court).

142. Donald L. Connors et al., *Developer Agreements: Affording Public Gain and Private Certainty in the Modern Development Regulatory Process*, A.L.I.—A.B.A. LAND USE INST. 1801, 1806 (1989) (finding that one impetus behind adoption of development agreement enabling statutes is diminution in property values which occurs from changing land use regulations). For a good overview on the effect of different stages of the development process on the vesting of development rights, see John J. Delaney, *Vested Rights and the Development Chronology—1991 Update*, A.L.I.—A.B.A. LAND USE INST. 515 (1991). The

subdivision regulations and conditional zoning by creating a property right in the proposed development.[143] In return for the vested right, the agreement provides the local government with an additional source of revenue or needed infrastructure.[144] This section will examine the legal bases underlying development agreements and the associated substantive and procedural requirements surrounding their creation.

A. *Legal Authority for Development Agreements*

Land use regulation and development are in a constant state of change.[145] While they are separate processes, regulation as a public

development agreement acts as a vesting mechanism and assures the developer that he may proceed with development under the existing statutory scheme at the time development is commenced. CAL. GOV'T CODE § 65864(b) (Deering 1991) (declaring legislative intent behind development agreements to act as assurance of development rights); League of California Cities, *Development Agreements* §§ 1.1, 1.6 (1980), *reprinted in* ALICE SUET YEE ET AL., DEVELOPMENT AGREEMENTS, 81, 86 (discussing legislative background behind California's enactment of development agreement enabling legislation as predicated on need to insure vesting of development rights). *See also supra* notes 31-40 and accompanying text (illustrating problem posed by changing land use scheme to developer who has incurred substantial start-up costs).

143. *See* Theodore C. Taub, *Exactions, Linkage, Vested Rights and Regulatory Takings*, HANDLING LAND USE & ENVTL. PROBS. OF REAL EST. 277, 318 (1990) [hereinafter Taub, *Exactions*] (equating vested right in development with "property" right); Hanes & Minchew, *supra* note 29, at 376 (indicating that legislative attempt to regulate vested right may constitute taking under Fifth Amendment). As opposed to a development agreement, which is specifically designed to vest the right in development, neither conditional zoning nor subdivision approval are sufficient in and of themselves to constitute a vested right, and thus fail to confer the same property interest on the developer. *See* Laurie Reynolds, *Local Subdivision Regulation: Formulaic Constraints in an Age of Discretion*, 24 GA. L. REV. 525, 573 (1990) (indicating that while states apply different standards in determination of vesting of rights in subdivision development, general touchstone is "substantial financial expenditure" and right may not even vest following final approval); Hanes & Minchew, *supra* note 29, at 392 (implying that as conditional zoning does not impose obligation on governmental unit, no vested right is created; but indicating that such zoning may satisfy requirement for government action in application of equitable estoppel analysis). *See, e.g.*, Gackler Land Co. v. Yankee Springs Township, 398 N.W.2d 393 (Mich. 1986) (holding that approval of subdivision plan and subsequent improvements failed to vest right in developer, where land was suitable for new zoning purpose); Dawe v. City of Scottsdale, 581 P.2d 1136, 1138 (Ariz. 1978) (failing to find vested right in substandard lots based on recording of plat); Board of County Supervisors v. United States, 23 Cl. Ct. 205 (1991) (indicating that conditional rezoning does not vest property right in development).

144. Callies & Grant, *supra* note 10, at 239. *See also* Connors et al., *supra* note 142, at 1805 (indicating that one motivating factor behind development agreement legislation was local government's desire to secure alternative funding source for infrastructure requirements).

145. Delaney, *supra* note 142, at 515.

function and development primarily a private function, they substantially impact on one another. Development must occur in compliance with the applicable regulatory scheme, while the rate and type of development may in turn define the regulatory scheme itself. To the extent that the regulatory environment is in a constant state of flux, the issue arises as to when a developer obtains a vested right in development. Or to put the question in other words: At what stage of real estate development may the developer complete a proposed development despite changes in the applicable land use regulatory scheme that now render the development nonconforming?

There are essentially two methods by which a developer may obtain a vested right in a development project. Many jurisdictions apply a bright line rule as to when sufficient development has occurred to vest the right to continued development in the developer.[146] The minimum standard adopted in most states is issuance of preliminary tract approval in the subdivision process.[147] Other states set the threshold at the issuance of a building permit.[148] In any case, it is likely that the developer will have incurred substantial expenditures and liabilities prior to a vesting of development rights.[149]

Maryland is one state which has adopted a rather stringent vested rights test.[150] In Maryland, in order to obtain a vested right

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146. *See* Kessler, *supra* note 27, at 453-54 (implying that courts apply early or late vesting approaches depending on whether jurisdiction is pro or anti developer); Daniel J. Curtin, *Legal Aspects of Development Agreements in General and the California Experience in Particular*, HANDLING LAND USE & ENVTL. PROBS. OF REAL EST., 551, 557 (1991) (stating that most states apply bright line test requiring issuance of building permit); Katherine E. Stone & Cristina L. Sierra, *Case Law on Public/Private Written Agreements*, *in* MANAGING DEVELOPMENT THROUGH PUBLIC/PRIVATE NEGOTIATIONS, *supra* note 7, at 99, 100 (indicating that courts prefer bright line rule to subjective estoppel analysis). The bright line rule adopted may allow for early or late vesting of the right to develop. *See generally* Daniel Hagman, *Estoppel and Vesting in the Age of Multi-Land Use Permits*, 11 SW. U. L. REV. 545 (1979) (providing general analysis of early versus late vesting jurisdictions). Jurisdictions that follow an early vesting approach, often apply a "last discretionary approval test." Curtin, *supra* note 146, at 558; *cf.* Milcrest Corp. v. Clackamas County, 650 P.2d 963 (Or. Ct. App. 1982) (vesting development right in planned unit development based on discretionary approval in first stages of development).

147. James A. Kushner, *Vested Development Rights, in* 1992 ZONING & PLANNING LAW HANDBOOK § 7.03[1][b], at 136 (Kenneth H. Young ed. 1992).

148. *See* Avco Community Developers, Inc. v. South Coast Regional Comm'n, 553 P.2d 546 (Cal. 1976), *cert. denied,* 429 U.S. 1083 (1977) (holding that development right does not vest until building permit has been issued); Courthouse Plaza Co. v. City of Palo Alto, 117 Cal. App. 3d 871, 884-87, *cert. denied,* 454 U.S. 1074 (1981). *See also* Curtin, *supra* note 146, at 557-59 (discussing harshness that results from application of bright line "building permit" vesting rule, and potential uncertainty rendered to development process).

149. *See supra* notes 31-40 and accompanying text.

150. *See* Offen v. County Council for Prince George's County, 96 Md. App. 526, 573, 625 A.2d 424, 448 (1993).

in development, a developer must meet a two prong test.[151] The first requirement is that the developer have obtained a valid permit.[152] The second requirement, and the one which most often results in litigation, is that the developer have commenced " 'a substantial beginning in construction and in committing the land to the permitted use before the change in the zoning ordinance ha[d] occurred.' "[153] This test requires that the construction be visible to the *public*.[154] If

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151. *See* Prince George's County v. Sunrise Dev. Ltd. Partnership, 330 Md. 297, 623 A.2d 1296 (1993) (providing comprehensive overview of Maryland's law on vested rights).
152. *See id.* at 307, 623 A.2d at 1301; O'Donnell v. Bassler, 289 Md. 501, 507, 425 A.2d 1003, 1007 (1981) ("Generally, in order to obtain a vested right in an existing zoning use that will be protected against a subsequent change in a zoning ordinance prohibiting that use, the owner must initially obtain a valid permit."); Lipsitz v. Parr, 164 Md. 222, 164 A. 743 (1933); *cf.* County Council for Montgomery County v. District Land Corp., 274 Md. 691, 707, 337 A.2d 712, 721 (1975).
153. *Sunrise Dev. Ltd. Partnership*, 330 Md. at 307, 623 A.2d at 1301 (quoting *O'Donnell*, 289 Md. at 507, 425 A.2d at 1007). This prong of the vested rights analysis requires actual *construction*, mere planning is not enough. *See District Land Corp.*, 274 Md. at 707, 337 A.2d at 721 (denying vested rights to developer who had obtained building permit and incurred more than $1,000,000.00 in studies and plans but had failed to commence actual construction prior to county's rezoning of property).
154. In *Sunrise Development Ltd. Partnership*, the developer had poured a footing and installed fencing at the site of its proposed development, prior to a rezoning which reclassified its property from multifamily high-density residential to multifamily medium density residential-condominium. 330 Md. at 299-302, 623 A.2d at 1297-99. A stop work order was issued before the developer could do any further work. This stop work order required the developer to obtain additional permits in accord with the rezoning. *Sunrise Dev. Ltd. Partnership*, 330 Md. at 302, 623 A.2d at 1299. The developer appealed the stop work order to Prince George's County Planning Board. The Board refused to vacate the order, and found that the footing did not constitute a "manifest commencement of . . . work . . . which everyone can readily see and recognize as the commencement of a building" in accord with Maryland vested rights law. *Id.* at 305, 623 A.2d at 1300.

    The developer appealed to the circuit court. The circuit court reversed the Board, holding that the footing sufficed to meet the commencement of the construction prong of vested rights analysis, because a member of the public could discover it upon proper inspection. *Id.* This holding was affirmed by the Court of Special Appeals of Maryland, which concluded that " 'the footing column was recognizable as the commencement of construction, upon inspection.' " *Id.* at 306, 623 A.2d at 1301.

    The Court of Appeals of Maryland reversed both courts and affirmed the Board's holding. It first reviewed Maryland's law on vested rights. The court then focused on whether Maryland law only required that the commencement of construction be recognizable to the "reasonably diligent building inspector" or the public at large. *Id.* at 308-11, 623 A.2d at 1302-03. The court of appeals concluded that Maryland law required that the *public* be able to see the a developer fails to meet this stringent test he has no vested right and, as such, must comply with any subsequent rezoning or permit requirements.

If a developer has not reached the stage of development required for the vesting of development rights, such a right may arise from the application of equitable estoppel. The line between a vested right founded in equitable estoppel analysis, as opposed to one that accrues under a jurisdiction's vested rights rules, is not always clear.[155] In applying an equitable estoppel analysis to determine whether a vested right has inured, the court will inquire into whether it would be unjust, given the developer's up front investment in reliance on specific government actions, to force the developer to modify or abandon his existing development plan. Such a finding estopps the local government from enforcing a subsequently enacted zoning ordinance, thereby implicitly vesting in the developer a property right in continued development.[156]

The primary criticism of the application of equitable estoppel in the determination of whether the developer's right to develop has vested, is that it is often subjective and arbitrary.[157] Under an

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construction. The court stated:

> In order for rights to be vested before a change in the law, the work done must be recognizable, on inspection of the property by a reasonable member of the public, as the commencement of construction of a building for a use permitted under the then current zoning.

Id. at 313, 623 A.2d at 1304.

155. Fry, *supra* note 12, at 485 (indicating that while doctrines of vested rights and equitable estoppel have different theoretical bases, courts have essentially merged the doctrines into one in determining whether a development right has vested); *cf.* Daniel J. Curtin & Michael H. Zischke, *Development Agreements: Securing Vested Rights and Project Completion Benefits*, *in* 1989 ZONING & PLANNING LAW HANDBOOK § 15.02 (Mark S. Dennison ed.), *reprinted in* Curtin, *supra* note 146, app. D at 609 (stating that equitable estoppel forms the basis of vested rights doctrine). *But cf.* Stone & Sierra, *supra* note 146, at 100 (citing to Cunningham & Kramer, *Vested Rights, Estoppel and the Land Development Process*, 29 HASTINGS L.J. 625, 629 (1978) and positing that while estoppel forms basis of vested rights doctrine, courts seldom actually apply estoppel analysis, preferring to opt for bright line rule determining when property rights vest).

156. *See* Hanes & Minchew, *supra* note 29, at 382-84 (indicating that while estoppel theoretically differs from doctrine of vested rights, the end result is same, and furthermore, that both doctrines consist of essentially identical elements); *see also supra* notes 150-55 and *infra* notes 157-66 and accompanying text (discussing application of equitable estoppel and attendant concerns).

157. Fry, *supra* note 12, at 492; *see* Taub, *Exactions*, *supra* note 143, at 318 (stressing subjective nature of determining good faith reliance); Delaney, *supra* note 142, at 517 (concluding that courts application of equitable estoppel in area of vested rights has resulted in "a hodge-podge of ad-hoc, case-by-case decision making by the judiciary").

equitable estoppel analysis the judiciary must decide the question of what degree of development or type of government action creates a vested right.[158] The application of a variety of different standards has resulted.[159]

In Maryland, the doctrine of equitable estoppel does not help a developer that has relied to its detriment on the issuance of a permit that a local government subsequently asserts was unlawfully issued.[160] Maryland courts have also adopted "zoning estoppel,"[161] which may provide some protection to a real estate developer. In Maryland, it appears that a real estate developer may invoke zoning estoppel to protect his development rights in cases involving particularly egregious acts by public officials specifically taken to prevent vesting.[162]

In addition to equitable estoppel or zoning estoppel, the case of *Mayor of Baltimore v. Crane*[163] may provide some protection to a real estate developer in Maryland. In *Crane*, the Maryland Court of Appeals applied a kind of hybrid equitable estoppel/vested rights

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158. *See* Hanes & Minchew, *supra* note 29, at 379 (indicating that ability of landowner to vest right of development is contingent on statutory interpretation and case law, which varies from jurisdiction to jurisdiction).
159. *See* Delaney, *supra* note 142, at 517-18 (delineating three tests often applied in estoppel analysis as: (1) the proportionate/ratio test; (2) balancing test; and (3) physical alteration of land test).
160. *See* United Parcel Serv., Inc. v. People's Counsel for Baltimore County, 93 Md. App. 59, 79, 611 A.2d 993, 1003 (1992) ("[A] municipality is not estopped to set up the illegality of a permit. And the issuance of an illegal permit creates no 'vested rights' in the permittee. *We have held . . . that the permits issued to the appellee were in violation of the zoning ordinance; consequently they were unlawful and did not estop the appellant from prosecuting this suit.*") (quoting Berwyn Heights v. Rogers, 228 Md. 271, 280, 179 A.2d 712, 716 (1962) (emphasis in original)).
161. Zoning estoppel differs from equitable estoppel in focus. Specifically, zoning estoppel is designed to "prevent [land use officials] from taking particularly egregious actions designed to prevent vesting and then relying on the absence of vesting to thwart the previously permitted plans of the developer." Offen v. County Council for Prince George's County, 96 Md. App. 526, 569 n.23, 625 A.2d 424, 446 n.23 (1993); *see also* Whitehead Oil Co. v. City of Lincoln, 451 N.W.2d 702, 704-07 (Neb. 1990); Faymor Dev. Co. v. Board of Standards and Appeals, 383 N.E.2d 100, 102-03 (N.Y. 1978).
162. *Offen*, 96 Md. App. at 567-78, 625 A.2d at 445-50, appears to be Maryland's latest work on the doctrine of equitable estoppel in the real estate development context. In *Offen*, the Court of Special Appeals of Maryland expressly adopted the doctrine of zoning estoppel. It stated: "[E]specially egregious actions of public officials in stalling the issuance of permits in order to eliminate development by downzoning may create a zoning estoppel as to particular properties." *Id.* at 577, 625 A.2d at 450.
163. 277 Md. 198, 352 A.2d 786 (1976).

analysis on behalf of a real estate developer.[164] Specifically, the Court of Appeals of Maryland held that the developer had acquired a vested *contractual* right in his proposed development and estopped the City from applying subsequent zoning enactments against the developer.[165] The City, following negotiations with the owners of a parcel of real estate, passed an ordinance which provided that where a landowner transfers a portion of his property to the City for highway purposes, he would still maintain the right to develop any retained land to the "same density . . . as would have been permissible prior to the conveyance."[166] In estopping the City from enforcing a subsequently passed ordinance which would have limited the developer's right to develop pursuant to the initial ordinance, the court held that while the initial ordinance did not create any vested right in the traditional sense, it had created a vested *contractual* interest. This interest guaranteed the developer's right to develop according to his initial plan and density.[167]

While *Crane* rests the right of the developer in contract, other cases apply equitable estoppel more generally and simply estop the municipality from enforcing a particular ordinance in the case of a specific development.[168] Regardless of the language used, the result is the same: The developer is exempted from the application of the ordinance and may continue development under the pre-existing scheme. *Crane* may be reconciled with more general estoppel or vested rights analysis in one of two ways. First, one may essentially ignore the language of the court and equate the right created to a property right similar to a transfer development right.[169] In the alternative, even if the right is contractual in nature, it is enforceable

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164. *See infra* notes 165-78 and accompanying text (examining *Crane* and reconciling its analysis with estoppel and vested rights analysis).

165. Mayor of Baltimore v. Crane, 277 Md. 198, 352 A.2d 786 (1976). In *Crane*, the city enacted an ordinance granting increases in density allowances to a developer in exchange for a dedication of property to the city. The developer complied with the terms of the ordinance by donating property, however a subsequent rezoning by the city overrode the developer's right to the added density. *Id.* at 202-05, 352 A.2d at 788-89. The court held that the developer's dedication of property created a vested *contractual* interest, as opposed to a purely vested interested or contract right, and this acted to estop the city from enforcing the subsequent legislation. *Id.* at 206, 352 A.2d at 790. For a general discussion of this case within the context of development agreements as contractual or regulatory in nature, see Wegner, *supra* note 24, at 1002-03.

166. *Crane*, 277 Md. at 202-03, 352 A.2d at 788.

167. *Id.* at 206, 352 A.2d at 790.

168. *See, e.g.*, The Florida Cos. v. Orange County, 411 So. 2d 108 (Fla. Dist. Ct. App. 1982); Benson v. City of DeSoto, 510 P.2d 1281 (Kan. 1973); Clackamus County v. Holmes, 508 P.2d 190 (Or. 1970).

169. *See* Wegner, *supra* note 24, at 1002-03.

under the Contract Clause of the Constitution.[170] Similarly the distinction between the right created under equitable estoppel or vested rights doctrine is one of analysis and theory, as opposed to result.[171] One caveat, however, is that the right founded in equitable estoppel analysis is a personal right. That is, it is specific to the developer and does not attach to the developer's estate.[172] Thus, a right based on equitable estoppel is probably not transferable or assignable with the property, while a vested right constitutes a property interest and, therefore, is assignable.[173]

Some state legislatures have attempted to narrow the inquiry into when rights vest by statutory enactments that define the occurrences vesting development rights.[174] Moreover, beginning with California in 1979, several states, including Hawaii, Nevada, Florida, Arizona, and, most recently, Louisiana, responded to their judiciaries' adoption of vesting rules that adversely impact real estate development through the enactment of enabling legislation which authorizes local governments to enter into development agreements with real estate developers.[175] This enabling legislation endows local governments with greater flexibility[176] in granting early vesting rights

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170. U.S. CONST., art. I, § 10, cl. 1. *See infra* notes 172, 179 and accompanying text (evaluating application of Contract Clause to development agreements); *cf.* Inlet Assoc. v. Assateague Condominium Ass'n, 313 Md. 413, 438, 545 A.2d 1296, 1308 (1988) ("[A] municipality may make an offer by ordinance which, if accepted and acted upon by another in compliance with its terms, may give rise to a contract, the obligation of which is constitutionally protected against impairment.") (citing *Crane*, 277 Md. 198, 352 A.2d 786).
171. *See supra* notes 150, 152, 153 and accompanying text.
172. *See, e.g.*, City of Parkland v. Septimus, 428 So. 2d 681 (Fla. Dist. Ct. App. 1983); Jones v. First Va. Mortgage, 399 So. 2d 1068 (Fla. Dist. Ct. App. 1981) (per curiam).
173. *See infra* notes 241-68, 279, 280 and accompanying text (arguing that right vested under development agreement is equivalent of real covenant that runs with the land or developer's estate and thus is assignable).
174. *See, e.g.*, CAL. GOV'T CODE § 66948.1(a) (Deering 1991) (establishing provisions for filing of tentative map vesting rights for limited period based on development approvals); PA. STAT. ANN. tit. 53, § 10508(4) (1991) (granting grace period from zoning and land use restriction changes for statutory term following platting of subdivision property); COLO. REV. STAT. §§ 24-68-101 to -106 (1991) (conferring vested property right upon approval of site specific development plan, inclusive of development agreements).
175. ARIZ. REV. STAT. ANN. § 9-500.05 (1991) (enacted in 1988); CAL. GOV'T CODE §§ 65864-65869.5 (Deering 1991) (enacted in 1980); FLA. STAT. ANN. §§ 163.3220 to .3243 (West 1991) (enacted in 1986); HAW. REV. STAT. §§ 46-121 to -132 (1991) (enacted in 1985); LA. REV. STAT. ANN. §§ 33:4780.21 to .33 (West 1991) (enacted in 1988); NEV. REV. STAT. ANN. §§ 278.0201 to .0207 (Michie 1991) (enacted in 1985); *cf.* COL. REV. STAT. §§ 24-68-101 to -106 (1991) (establishing vested property right in development, following approval of development agreement).
176. *See* Taub, *Development Agreements*, *supra* note 141, at 558-59 (examining

to developers in exchange for specified consideration by the developer.[177] The legislation establishes a regulatory scheme that encompasses both procedural and substantive guidelines and requirements governing the terms and form of development agreements.[178] Before discussing these guidelines and requirements, the next section examines the constitutional implications of development agreements.

B. *Constitutional Implications*[179]

1. The Contract Clause

Development agreements constitute contracts between a municipality and a real estate developer and thus implicate the Contract Clause of the Constitution.[180] By freezing land use regulations, development agreements act as a limitation on the power of future legislatures, thus raising the specter of a violation of the reserved powers doctrine.[181] This doctrine establishes the principle that a government may not bargain or contract away its police power and limits the enforceability of contracts under the Contract Clause.[182]

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benefits resulting from development agreements to both developer and local government, and concluding that development agreement allows tailoring of development to specific needs of community); League of California Cities, *supra* note 142, § 1.1, *reprinted at* 81 (stressing flexibility provided by statute in order to meet specific local community needs).

177. *See supra* notes 12, 139, 141, 143 and accompanying text (discussing bilateral nature of development agreements, inclusive of mutuality of enforcement and relevant consideration).

178. *See generally* Wegner, *supra* note 24, at 995-1003 (discussing substantive and procedural requirements of differing states' development agreement enabling legislation); Connors et al., *supra* note 142, at 1806-25 (summarizing different components and requirements of varying development agreement statutes); *see also infra* notes 203-19 and accompanying text (providing overview of statutory requirements).

179. For comprehensive overviews of the constitutional questions implicated by development agreements, see generally Wegner, *supra* note 24; Kessler, *supra* note 27, at 464-72; Stone & Sierra, *supra* note 146, at 102-17.

180. U.S. Const. art. I, § 10, cl. 1. The Contract Clause bars government from impairing contracts. For a general discussion of the Contract Clause and its meaning, see Janice C. Griffith, *Local Government Contracts: Escaping From the Governmental/Proprietary Maze,* 75 Iowa L. Rev. 277 (1990).

181. *See* Callies & Grant, *supra* note 10, at 241-43 (examining development agreements as potential violation of reserved powers doctrine and concluding that courts primarily apply principle to invalidate government actions that bind future legislature infinitely); Kessler, *supra* note 27, at 464-69 (examining applicable framework for determining when a contract implicates the police power and is thus invalidated).

182. *See* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977), *reh'g denied,* 431 U.S. 975 (1977) (reviewing history of reserved powers and implications for

Development agreements directly implicate this inherent tension between the Contract Clause of the Constitution and the reserved powers doctrine.[183] To date, no court has specifically addressed the constitutionality of development agreements within this context.[184] While facially such agreements appear to violate the reserved powers doctrine in that they implicate land use regulation, which is clearly within the police power,[185] several arguments support the constitutionality of development agreements.[186] Moreover, local governments

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power of present government to bind future government actions through contract, and establishing analytical framework for determining when contract illegally bargains away police power as question of whether power is an "essential attribute of sovereignty"). *Id.* at 23. The general rule is that a legislature may not enter into a contract which binds future legislatures because this is a bargaining away of the police power. *See id.*; *see also* Wegner, *supra* note 24, at 962-77 (providing comprehensive overview of reserved power doctrine).

183. *See* Wegner, *supra* note 24, at 971-75 (discussing interaction of Contract Clause and reserved power doctrine in public-private contracting); Kessler, *supra* note 27, at 464-69 (analyzing interaction of Contract Clause and reserved powers doctrine in validity of development agreements); Fry, *supra* note 12, at 497 (considering conflict and tension existing between Contract Clause and police power).

184. *See* Curtin, *supra* note 146, at 559 (discussing construction of development agreement as obligation of contract or violation of reserved powers doctrine and indicating that while no appellate court has yet addressed constitutionality of agreements, statute is presumptively valid until judicial decision to contrary); *cf.* Urban West Communities v. City of Moorpark, No. 100258, (Cal. Super. Ct. 1988), *reprinted in* Connors et al., *supra* note 142, at 1851 (holding development agreement enforceable against municipality under principle of estoppel and concluding that there was no invalid contracting away of police power).

185. *See* Euclid v. Ambler Realty, 272 U.S. 365 (1926) (upholding zoning as valid exercise of police power); Nollan v. California Coastal Comm., 483 U.S. 825 (1987); *see also* Fry, *supra* note 12, at 498 (citing *Avco* decision for the proposition that agreement contracting away government's police power that extends to land use regulation in the future, would be void as contrary to public policy).

186. One potential argument that supports the constitutionality of development agreements, is that they are in fact an exercise of the police power. Connors, *supra* note 142, at 1855 (stating that government exercised police power in approving development agreement). Furthermore, arguably the Contract Clause itself may act as a limiting factor on the police power. *See United States Trust Co.*, 431 U.S. at 17 n.14; *see also supra* note 174 and accompanying text, (discussing *United States Trust Co.* decision and contract impairment analysis); *cf.* Lincoln Property Co. v. Torrance, No. C607339, slip. op. (Super. Ct. County of Los Angeles, Cal., November 4, 1986) (implying in dicta that development agreement vests property right under terms delineated by agreement, while upholding local government actions as not inconsistent with terms of agreement); Callies & Grant, *supra* note 10, at 242 (implying that invalidation of government action under reserved powers doctrine may be limited to cases where contracting is for indefinite time, and noting trend towards upholding

presently continue to use development agreements, regardless of their potentially questionable constitutionality.[187]

2. The Due Process Clause

Development agreements may also be attacked on due process grounds.[188] The extent to which such agreements implicate due process concerns depends on their characterization as legislative, quasi-judicial, or administrative in nature.[189] This characterization will directly impact on the degree of judicial scrutiny applied in examining development agreements, as well as the remedies available.[190] California, in its enabling legislation, specifically labels development agreements as legislative in nature.[191] Louisiana, which has most recently enacted enabling legislation, has followed this characterization, as have a number of other states.[192] As a legislative act, the development

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government contracts when reasonable); Fry, *supra* note 12, at 500-02 (analogizing case law in similar areas to development agreements, such as annexation agreements and contract or conditional zoning, and concluding that trend may be away from implying limitless police power and towards upholding government contracts). *See generally* Wegner, *supra* note 24, at 1008-23 (analyzing and providing framework for constitutional analyses of development agreements as violation of reserved powers doctrine and corresponding implications of Contract Clause).

187. Lindell L. Marsh, *The Future of Development Agreements*, DEVELOPMENT AGREEMENTS, *supra* note 11, at 153 [hereinafter Marsh, *Future*] ("No question: Development agreements are here to stay."); *see* Callies & Grant, *supra* note 10, at 243 (concluding that, in light of existing case law, it is unlikely that development agreement statutes will be struck down as unconstitutional).

188. Wegner, *supra* note 24, at 1008.

189. A legislative act is one establishing public policy; an administrative act is one executing public policy; and an adjudicatory act is one involving the application of general standards to a specific factual context. Stone & Sierra, *supra* note 146, at 111-12; Wegner, *supra* note 24, at 1011-13.

190. Legislative acts are generally subject to challenge by referendum or initiative. Courts will apply greater deference in considering legislative validity, and due process concerns are not implicated. Furthermore, its construction is a legal question and the parties' intent may be irrelevant. Stone & Sierra, *supra* note 146, at 111. Administrative acts fall within the rules applicable to contracts and therefore are subject to greater constitutional scrutiny in light of the Contracts Clause of the United States Constitution. *Id.* at 112; *see also supra* notes 172, 179 and accompanying text (discussing implications of Contract Clause for development agreements). Adjudicative acts implicate due process concerns under the Constitution, including the necessity of hearing and notice. Stone & Sierra, *supra* note 146, at 112.

191. CAL. GOV'T CODE § 65867.5 (Deering 1991).

192. LA. REV. STAT. ANN. § 33:4780.29 (West 1991) ("A development agreement shall be approved by ordinance of the governing authority of the parish or municipality."); *see also* FLA. STAT. ANN. § 163.3223 (West 1991) (requiring that local government establish ordinances regulating procedures and requirements governing development agreements, and identifying such agreements as

agreement assumes a presumption of constitutional validity, as well as immunization from many of the procedural due process requirements that are imposed on quasi-judicial acts.[193] Conceptually, development agreements, however, do not appear to conform to notions of what constitutes a legislative act.[194] Furthermore, courts are not bound by a legislative label but rather they will undertake their own inquiry into the actual nature of the particular act.[195] Because courts have yet to determine the exact characterization of the development agreement, it is advisable to structure such agreements in a manner that addresses the due process concerns arising if the agreement is determined to be quasi-judicial in nature,[196] as well as comply with all of the proper requisites for contractual formation, inclusive of adequate consideration.[197]

3. The Takings Clause

The final constitutional challenge to development agreements rests in the Takings Clause.[198] The Takings Clause poses the question of whether the exaction, imposed on the developer by the development agreement, violates the Fifth Amendment prohibition against government takings without just compensation.[199] The Supreme Court has yet to offer a definitive test for deciding when a government regulation constitutes a taking under the Fifth Amendment.[200] In

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legislative in nature); NEV. REV. STAT. ANN. § 278.0203 (Michie 1991) (requiring that development agreement be approved by ordinance). *But cf.* HAW. REV. STAT. § 46-131 (1991) (classifying development agreement as administrative act by governmental unit party to agreement).

193. Daniel J. Curtin, Jr. & Sanford M. Skaggs, *Legal Issues and Considerations*, *in* DEVELOPMENT AGREEMENTS, *supra* note 11, at 121, 129; *see also supra* note 181 and accompanying text (distinguishing legislative, administrative and quasi-judicial acts).
194. Stone & Sierra, *supra* note 146, at 111; Curtin & Skaggs, *supra* note 193, at 130. Because a development agreement addresses a specific factual setting it appears to be more adjudicative in nature. Stone & Sierra, *supra* note 146, at 111. The fact that the development agreement directly implicates zoning, however, leans towards its classification as a legislative act. *Id.*
195. Curtin & Skaggs, *supra* note 193, at 130 (stating that label is subject to judicial override based on common law doctrine and constitutional law).
196. Stone & Sierra, *supra* note 146, at 112 (stating that to ensure validity as quasi-judicial act, development agreement should provide for notice and be based on substantial evidentiary record, thus complying with due process concerns).
197. *Id.* (stating that contractual nature may reflect implementation of policy rendering agreement administrative act, subject to contractual requirements and protection under Contract Clause of United States Constitution).
198. U.S. CONST. amend. V. (providing in relevant part, "nor shall private property be taken for public use, without just compensation").
199. *Id. See generally* Michael H. Crew, *Development Agreements After Nollan v. California Coastal Commission*, 22 URB. LAW. 23 (1990) (discussing impact of *Nollan* holding on constitutionality of development agreement exactions).
200. BRIAN W. BLAESSER, ET AL., LAND USE AND THE CONSTITUTION 68-69 (Brian

Nollan v. California Coastal Commission,[201] the Court applied a two prong test to decide whether an exaction constituted a taking. First, the Court required that the regulation or exaction "substantially advance" a "legitimate state interest," in order to avoid classification as a taking.[202] The second requirement was that the regulation/exaction not deny an owner economically viable use of its property.[203] In analyzing the substantial advancement prong of the test, the Court formulated a rational nexus requirement.[204] This rational nexus test is met where the exaction imposed seeks to mitigate the condition that underlies the regulation.[205]

More recently, in *Dolan v. City of Tigard*,[206] the Supreme Court clarified its opinion in *Nollan*. Specifically, it reaffirmed its commitment to *Nollan*'s requirement that an "'essential nexus' exist[] between the 'legitimate state interest' and the permit condition exacted by the [governmental unit]."[207] The Court then went on to explore the "required degree of connection between the exactions and the projected impact of the proposed development."[208] In *Dolan*, the Supreme Court held that in order for an exaction to survive a takings challenge, the local government unit seeking to impose the exaction

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W. Blaesser & Alan C. Weinstein eds. 1989) (discussing failure of Supreme Court to identify specific test for what constitutes a regulatory taking and stating that the Court generally applies ad hoc balancing test). A number of different judicial standards have been applied in determining what constitutes a taking. *See, e.g.*, Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470 (1987) (upholding coal subsidence regulations as furthering legitimate state interest, while not denying owner an economically viable use of property); Agins v. City of Tiburon, 447 U.S. 255 (1980) (applying two pronged ends-means, rational nexus test in upholding zoning ordinance that restricted development of residential property); Penn Cent. Trans. Co. v. City of New York, 438 U.S. 104 (1978) (upholding landmark restriction and applying test of reciprocity of advantage).

201. 483 U.S. 825 (1987).

202. Nollan v. California Coastal Comm'n, 483 U.S. 825, 834 (1987) (quoting Agins v. City of Tiburon, 447 U.S. 255, 260 (1980)).

203. *Id.* (citing *Agins*, 447 U.S. at 260).

204. In *Nollan*, the Court stated that "unless the permit condition serves the same governmental purpose as the development ban, the building restriction is not a valid regulation of land use but an 'out and out plan of extortion.'" 483 U.S. at 837 (citations omitted); *see also* Crew, *supra*, note 199, at 35-37 (discussing Court's formulation of standard governing required link between exaction and permitted use, and concluding that it most closely resembles the rational nexus test, despite Court's declining to specifically adopt standard). Thus, the exaction imposed must be linked to the condition that would permit a regulation of the land use.

205. *Nollan*, 483 U.S. at 834; *see also* Crew, *supra* note 199, at 51-52 (proposing that tying of exaction to impact of proposed development meets *Nollan* test and provides for reciprocity of advantage).

206. 114 S. Ct. 2309 (1994).

207. *Id.* at 2317 (citing *Nollan*, 483 U.S. at 837).

208. *Id.*

must "make some sort of individualized determination that the required dedication is related both in nature and extent to the impact of the proposed development."[209] It labelled this inquiry one of "'rough proportionality.'"[210]

Under *Nollan* and *Dolan*, it appears that so long as a municipality concludes that a proposed exaction will in most likelihood eradicate an adverse impact on the community resulting from the proposed development, that exaction will survive a takings challenge.[211] Thus, a municipality that could validly limit density in a particular zone because of concerns related to traffic, could impose an exaction requiring a developer to construct roads for the proposed development, or contribute to a transportation fund, so long as there is a finding by the municipality that these exactions would offset some of the increased traffic resulting from the development.[212] Similarly, to the extent the exaction imposed by the development agreement is linked to a consequence of the proposed development it will in all likelihood survive a takings attack under the principle of *Nollan* and *Dolan*.

The bilateral nature of the development agreement may also undermine a constitutional takings challenge. In *Leroy Land Development v. Tahoe Regional Planning Agency*,[213] the Ninth Circuit Court of Appeals examined a constitutional takings challenge to an exaction requirement imposed by a settlement agreement between a developer and a government agency. The court stated that "a takings analysis as articulated in *Nollan* is inapplicable where, as here, the parties choose to terminate or avoid litigation by executing a settlement agreement supported by consideration."[214] Similarly, a devel-

209. *Id.* at 2319-20.

210. *Id.* at 2319.

211. *See, e.g., Dolan*, 114 S. Ct. at 2321-22. While *Dolan* requires that a municipality make a finding supporting the relationship between the proposed exaction and the impact of the development, it fails to establish a clear rule as to the sort of findings required to survive a takings challenge. The Court states: "No precise mathematical calculation is required, but the city must make some effort to quantify its findings in support of the [proposed exaction] . . . beyond the conclusory statement that it *could* offset some of the [adverse impact of the development.]" *Id.* at 2322 (emphasis added). Under *Dolan*, "could" is clearly insufficient, but "will" or "is likely to" appear to be enough. *Id.* (quoting Justice Peterson's dissent in the underlying case, Dolan v. City of Tigard, 854 P.2d 437, 447 (Or. 1993), *rev'd*, 114 S. Ct. 2309 (1994), that a finding that the adverse impact could be offset "is a far cry from a finding that . . . [it] will, or is likely, to" be offset.).

212. *See, e.g.,* Russ Bldg. Partnership v. City & County of San Fransico, 750 P.2d 324 (Cal. 1988) (upholding city mass transit assessment in downtown development context).

213. 939 F.2d 696 (9th Cir. 1991).

214. Leroy Land Dev. v. Tahoe Regional Planning Agency, 939 F.2d 696, 699 (9th Cir. 1991).

opment agreement is bilateral in nature and supported by consideration.[215] The court in *Leroy* continued, holding that even if *Nollan* analysis was applicable, there was a substantial relationship between the exaction and the regulations, making it clear that an exaction will survive the rational nexus test where it is related to the proposed development itself.[216]

C. *Statutory Requirements*

The enabling statutes define the development agreement's process and substance. In addition, these statutes provide a legislative background, rendering the agreements less constitutionally suspect as either an overstepping of the police power or an infringement on the reserved powers doctrine. They also delineate the required nexus between the imposed exaction and the proposed development, in order to avoid the implication of a takings problem.

Statutory enabling acts establish mandatory procedural requirements. These requirements include provisions mandating public notice, the holding of public hearings regarding a proposed development agreement,[217] and the establishment of periodic monitoring provisions designed to ensure timely compliance with the terms of the agreement.[218] Furthermore, it is common practice that a development agreement only becomes effective upon the adoption of an ordinance specifically memorializing its terms.[219]

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215. *See supra* notes 12, 139, 141, 143 and accompanying text.
216. *Leroy Land Dev.*, 939 F.2d at 699.
217. *See, e.g.*, CAL. GOV'T CODE § 65867 (Deering 1991) ("Public hearing on application for development agreement; Notice."); FLA. STAT. ANN. § 163.3225 (West 1991) ("Public hearings."); HAW. REV. STAT. § 46-128 (1991) ("Public hearing."); LA. REV. STAT. ANN. § 4780-28 (West 1991) ("Public hearing; Notice of intention to consider adoption.").
218. *See, e.g.*, CAL. GOV'T CODE § 65865.1 (requiring annual review, indicating demonstrable good faith compliance on part of developer); FLA. STAT. ANN. § 163.3235 (imposing annual periodic review for good faith compliance, similar to that under California law); HAW. REV. STAT. § 46-125 (providing for notice of material breach following periodic review, as well as opportunity to cure defect); NEV. REV. STAT. ANN. § 278.0205 (requiring governmental review biannually, providing for agreement cancellation upon developer default). Other procedural requirements imposed under statutory enabling acts are a requirement of recordation of the agreement, acting as notice to public of terms of agreement. CAL. GOV'T CODE § 65868.5; *see also* CAL. GOV'T CODE § 65865 (requiring that every local government unit wishing to utilize development agreements enact ordinance establishing procedures and requirements governing consideration of development agreements).
219. *See* CAL. GOV'T CODE § 65867.5 ("A development agreement is a legislative act which will be approved by ordinance . . . ."). Under the California statutory scheme, which labels development agreements as legislative actions, development agreements are subject to referendum. *Id.*

In addition to establishing procedural guidelines, the statutes delineate mandatory substantive requirements. The California statute is typical in requiring that the development agreement specify "the duration of the agreement, the permitted uses of the property, the density and intensity of use, the maximum height and size of proposed buildings, and provisions for reservation or dedication of land for public purposes."[220] In addition, the statutory scheme may indicate other matters to be addressed or specified by the agreement.[221]

The statutes provide that the local government unit may enter into a development agreement with any person having a legal or equitable interest in real property.[222] This may be understood to mean that the appropriate parties negotiating the agreement are the developer and the local government unit. Wherever possible, however, the parties to the agreement's negotiation should include not only the relevant local government unit and developer, but also the entity that will provide the financing for the development.[223] This is in accord with the proposition of this Article that development agreements enhance the creditworthiness of a particular development project. A development agreement accomplishes this enhancement by injecting a degree of certainty into the real estate development process.[224] To

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220. CAL. GOV'T CODE § 65865.2; *see also* LA. REV. STAT. ANN. § 33:4780.24 (requiring that agreement include duration of the agreement, permitted uses of property, density or intensity of use, maximum height and size of proposed buildings, and provisions for reservation or dedication of land for public purposes); HAW. REV. STAT. § 46-126 (requiring description of property; specification of permitted uses, density, height and size; provisions for dedication of land; and termination date).

221. *See, e.g.*, HAW. REV. STAT. § 46-126(c) (stating that development agreement may include commencement dates, as well as "any other matter not inconsistent with this chapter, nor prohibited by law"); FLA. REV. STAT. § 163.3227 (providing that development agreement may specify commencement or completion dates for any phase of multi-phase development); LA. REV. STAT. ANN. § 33:4780.24 (stating that agreement may include "conditions, terms, restrictions, and requirements for subsequent discretionary actions;" timing requirements or "terms and conditions relating to financing of necessary public facilities").

222. NEV. REV. STAT. ANN. § 278.0201; HAW. REV. STAT. § 46-123; LA. REV. STAT. ANN. § 33:4780.22; *cf.* ARIZ. REV. STAT. § 9-500.05.A ("A municipality . . . may enter into development agreements relating to property in municipality. . . .").

223. This is so because the structure and terms of the agreement may impact its viability as a financeable vehicle in the real estate finance market. *Cf. supra* notes 99-101 and accompanying text (discussing need for lender involvement in negotiation of lease that is to be object of leasehold financing).

224. *See supra* notes 138-42, 144 and accompanying text (discussing development agreements as tool for vesting development right).

the extent that the lender is included in the initial negotiations of the agreement it is easier to design the agreement in a manner consistent with the lender's concerns.[225]

In delineating the applicable duties and obligations of the parties, the statutes provide that the land use regulations applicable to the development will be those in effect at the time the developer and the municipality execute the agreement.[226] This freezes the applicable land use scheme with respect to development, and vests the right to develop according to the developer's plan. Finally, some statutes require that the development agreement comply with the comprehensive plan.[227]

D. *Noncompliance and Effect*

Remedies for noncompliance with a development agreement may be set forth in both the enabling legislation and the agreement itself. To enforce and oversee compliance by the developer, state enabling legislation requires that the municipality conduct a periodic review of the developer.[228] If this review indicates that the developer has breached or is failing to comply with the terms of the agreement, the statute provides for unilateral amendment or termination of the agreement by the municipality.[229] California, Hawaii, Florida, and Louisiana take the issue of enforcement one step further by statutorily providing for the remedy of specific performance.[230] In addition to the statutory remedies for noncompliance, the agreement may further identify those events or conditions that represent material breaches or noncompliance and specify corresponding rights and remedies. Judicial construction of the agreement as a covenant running with the land, or real covenant,[231] would provide a further source of

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225. *See infra* notes 228, 268, 279, 280, 308 and accompanying text (outlining potential concerns of lender in development agreements, used to secure financing).

226. CAL. GOV'T CODE § 65868; FLA. REV. STAT. § 163.3233; HAW. REV. STAT. § 46-127; LA. REV. STAT. ANN. § 33:4780.27. These same provisions provide that subsequently enacted land use regulations are applicable to the development, but only to the extent that they do not conflict with the development delineated by the agreement.

227. FLA. REV. STAT. § 163.3231; HAW. REV. STAT. § 46-129.

228. *See supra* note 204 and accompanying text (providing statutory examples of procedural requirement of periodic review).

229. CAL. GOV'T CODE § 65865.1; FLA. REV. STAT. § 163.3235; LA. REV. STAT. ANN. § 33:4780.23; NEV. REV. STAT. ANN. § 2780.0205; *cf.* HAW. REV. STAT. § 46-125 (requiring notice of noncompliance with opportunity to cure defect, prior to termination of agreement).

230. CAL. GOV'T CODE § 65865.4; FLA. REV. STAT. § 163.3243; HAW. REV. STAT. § 46-127; LA. REV. STAT. ANN. § 33:4780.26.

231. *See infra* notes 259-77 and accompanying text (proposing that development agreement be construed as real covenant and analyzing in terms of common law requirements of running covenants).

remedial protection because such a construction would allow for the associated common law rights and remedies.[232] Finally, it is possible that a municipality might require security through either the posting of a performance bond or letter of credit.[233]

Governmental noncompliance under the agreement is slightly more complicated. The issue of governmental noncompliance is directly related to the constitutional questions raised by such agreements.[234] Three separate analyses must be undertaken: constitutional takings,[235] impairment of contract,[236] and common law contract.[237] A change in government regulation that is applied to a post-agreement development deprives the developer of its vested right under the agreement. To the extent that the vested right constitutes a property right, the government breach will be subject to constitutional takings analysis. In the case of a negotiated development agreement, supported by valid consideration, the municipality's breach, or attempt to enforce a subsequently enacted regulation to the detriment of the proposed development, interferes with the developer's investment backed expectations.[238] A court will examine the nature of the government action, as well as the post hoc regulations' impact.[239] Because

232. *See* Roger A. Cunningham et al., The Law of Property § 8.21 (1984) (listing remedies associated with breach of covenant as being injunction against future breach and entitlement of damages).

233. *See* River Vale Planning Bd. v. E & R Office Interiors, 575 A.2d 55, 56-57 (N.J. Super. Ct. App. Div. 1990) (examining developer's attempt to recoup performance bond following decision to withdraw from development agreement).

234. *See supra* notes 171-202 and accompanying text (exploring constitutional issues implicated by development agreements).

235. *See* Wegner, *supra* note 24, at 1030-35 (analyzing governmental non-compliance with terms of agreement vis a vis Takings Clause); *see also supra* notes 190-202 (laying out constitutional takings analysis applicable to development agreements).

236. *See* Wegner, *supra* note 24, at 1036-38 (identifying impairment of contract doctrine as major concern for breaching governmental agency and stating that critical question will be whether or not government can justify actions); *see also supra* notes 172-79 (discussing impairment of contract doctrine and application to development agreements).

237. *See* Wegner, *supra* note 24, at 1035-36 (stating that as general rule, parties may seek common law contract remedies including, restitution, consequential damages, and specific performance); *see also supra* note 189 (discussing need for development agreement to comply with requisite contract formation requirements, in order to be binding as administrative act).

238. *See* Wegner, *supra* note 24, at 1030-35 (citing Kaiser Aetna v. United States, 444 U.S. 164 (1979) ("[W]hen government representations concerning the conditions associated with the issuance of a development permits [lead] a developer to make substantial investment in the project in question, distinct investment-based expectations [are] created, and [can] not be infringed by subsequent changes in government policy.")).

239. *See supra* notes 190-202 and accompanying text (outlining constitutional takings analysis).

the impact of the post hoc application of the regulation may effectively deprive the developer of the ability to complete development, a court will find a taking unless the regulation is supported by a substantial public health or safety concern.[240] The remedy will be an injunction against government enforcement of the regulation.[241]

Under impairment of contract analysis a court is similarly likely to enforce the agreement.[242] Enforcement, however, is subject to limitation where the noncompliance is related to the municipality's exercise of its police power.[243] Finally, if the agreement is upheld as a valid contract and the municipality breaches the agreement, the court may apply straight forward contract law and give any corresponding remedy.[244]

V. DEVELOPMENT AGREEMENT AS A FINANCEABLE INSTRUMENT

A construction lender's key concern in extending real estate financing is the developer's ability to repay the loan. Completion of the proposed development is essential to the loan's repayment.[245] Failure to complete the proposed construction in a timely fashion and within budget materially impairs the value of the collateral property in addition to diminishing or eliminating the availability of takeout financing.[246] Thus, in evaluating a proposed real estate development project, the lender will be alert to any potential threats to timely completion. A change in the applicable land use restriction scheme represents one such potential threat. Such a change may impose substantial additional costs and delays on the development process and, in an extreme case, may render completion too costly

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240. *See* Wegner, *supra* note 24, at 1032-33.

241. *See id.* at 1033. Damages may also be available. *See* First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304 (1987).

242. *See supra* notes 172-75 and accompanying text (discussing inherent tension between Contracts Clause and reserved powers doctrine).

243. *See supra* notes 190-202 and accompanying text (providing overview of takings questions raised by development agreement, including validation of action as within police power and thus not a taking).

244. *See* Wegner, *supra* note 24, at 1035 (positing that developer may seek damages and specific performance in breach of contract action).

245. *See supra* notes 64-87 and accompanying text (discussing lender concerns in land development and construction phases as centering around completion of development because of strong relationship between completion of project and material value of collateral property).

246. *See supra* notes 5, 15, 54, 58, 81, 82, 86, 135 and accompanying text (discussing use of takeout financing commitment as insurance to construction lender of future repayment, but indicating that substantial delay in completion may cancel commitment, thus rendering repayment less certain).

or unfeasible.[247] This risk exists until the developer obtains a vested right in the development of the proposed project.[248]

This section proposes that development agreements create and convey a property interest to the developer that increases the value of the real estate used as collateral in securing construction financing. By according the developer the right to develop, the agreement not only contributes greater predictability and certainty in the development process, but actually provides an additional component to the property mortgaged. This section first defines the development agreement as a real property interest. Second, it discusses the structure and terms of the agreement that are essential in rendering it a viable financeable device. Finally, it concludes with a discussion of the assignability and enforceability of the agreement.

A. Development Agreement as a Real Property Interest

Development agreements, by freezing the applicable land use regulatory scheme, vest the right of development in the developer.[249] In fact, state legislatures enacted development agreement statutes to address the problems associated with the late vesting of development rights as well as to provide greater flexibility to municipalities in the land use planning process.[250] A vested right in development represents one of the key sticks in the bundle that constitutes real property.[251] By expressly identifying this interest and separately granting it to the

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247. *See* Crew, *supra* note 199, at 29 (acknowledging that lack of vested right and corresponding uncertainty in development process causes lenders concern and results in higher interest rates on land use development loans); *see also supra* notes 31-40 and accompanying text (illustrating problems that changing land use scheme imposes on real estate development process).

248. A vested right serves to freeze the land use regulatory scheme as applied to that particular development. It freezes the land use scheme, however, only to the extent necessary to preserve the developer's right to develop as originally agreed. Any subsequently enacted regulations that do not directly conflict with the delineated frozen land use scheme are still valid. CAL. GOV'T CODE § 65866 (West 1983).

249. *See supra* notes 138-42, 144 and accompanying text (discussing use of development agreements to vest development rights).

250. *See* Marsh, *supra* note 13, at 3-4. The California enabling legislation specifically declares that the motivation behind the legislation is the need to provide

> [a]ssurance to the applicant for a development project that upon approval of the project, the applicant may proceed with the project in accordance with existing policies, rules and regulations, and subject to conditions of approval, [that] will strengthen the public planning process, . . . and reduce the economic costs of development.

CAL. GOV'T CODE § 65864(b) (West 1983); *see also supra* notes 165-70 and accompanying text (discussing legislative efforts to confront vested rights problem through statutory enactments).

251. CUNNINGHAM ET AL., *supra* note 232, § 1.1.

developer, a development agreement augments the property held by the developer.[252] In other words, the development agreement conveys a real property interest to the developer. The court's holding in *Mayor of Rockville v. Walker*[253] supports such a construction. In *Walker*, the development agreement vested an executory interest in the municipality.[254]

Analogously, Transfer Development Rights (TDRs) provide support for the thesis that the right created by the development agreements is a real property interest. TDRs separate the right to develop from the bundle of rights a landowner possesses, rendering it a separable property component.[255] In so doing, statutes that establish TDRs recognize the right to develop as a distinct property right.[256] The idea underlying a TDR scheme is that once established as a discrete right, the right can then be transferred to another piece of property, and used to increase the development rights for that property.[257] Similarly, by vesting a development right in the developer, development agreements recognize a discrete property right in development.

Finally, commentators have posited that zoning ordinances create collective public property rights in a particular zoning scheme, which are vested in the local government.[258] Under this thesis, one might

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252. *See supra* notes 141-44 and accompanying text (contrasting development agreements, which create property rights, with conditional zoning and subdivision regulations, which do not have same effect); *see also* P & L Properties, Inc. v. Schnip Dev. Corp., No. 311354, 1992 Conn. Super. LEXIS 3234, at *9 (Conn. Super. Ct. Sept. 28, 1992) ("[T]he development rights and obligations arising from the Development Agreement were 'property'. . . .") (dicta).

253. 86 Md. App. 691, 587 A.2d 1179 (1991).

254. *Id.* at 699, 587 A.2d at 1182-83; *see also supra* notes 42-52 and accompanying text (discussing *Walker* in detail).

255. Madelyn Glickfeld, *Update on Transfer of Development Rights, in* ALI-ABA LAND USE INST. 1377, 1377 (1989).

256. *Id.*

257. *Id.; see also* Norman Marcus, *Air Rights In New York City: TDR, Zoning Lot Merger, and the Well-Considered Plan*, 50 BROOK. L. REV. 867, 870 n.11 (1984) ("TDR is the term used to describe a variety of techniques that involve the transfer of air rights from one zoning lot to another that is either contiguous or non-contiguous to the original lot.").

258. *See* ROBERT H. NELSON, ZONING AND PROPERTY RIGHTS: AN ANALYSIS OF THE AMERICAN SYSTEM OF LAND-USE REGULATION 1 (1977) (defining a property right as "the authority it creates to control the use of property," and concluding that zoning serves to divide up control of land uses between private owner and local government); *see also* WILLIAM A. FISCHEL, THE ECONOMICS OF ZONING LAWS: A PROPERTY RIGHTS APPROACH TO AMERICAN LAND USE CONTROLS 1, 36 (1985) (examining zoning through application of economic analysis based on premise that land use controls represent collective property rights, presently controlled by local government, but opining that market place is most efficient mechanism for land use decisionmaking); *cf.* BRIAN W. BLAESSER ET AL., *supra*

view the development agreement as transferring the publicly held zoning property right to the private developer on a conditional basis.[259] The development agreement thus resembles a defeasible property right in the applicable zoning scheme.

Turning to the classification of the property interest created by a development agreement, it is clear that it is not perpetual[260] because the development agreement itself has a fixed term.[261] Furthermore, the property right is contingent upon the developer's compliance with its end of the bargain.[262] As illustrated by the earlier discussion of *Mayor of Rockville v. Walker*, a development agreement may impose a condition on the title of the property, thereby creating a defeasible estate.[263] In *Walker*, the development agreement actually affected the transfer of the subject property and thus, construing the agreement as creating a defeasible estate seems logical.[264] But even if the development agreement only creates and conveys a separable property

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note 200, at 8-9 ("A property interest is merely a person's right to have the benefits of the particular type of interest the person holds in the property."). In attempting to provide a legal overview of the constitutional implications associated with land use regulation, this book indicates that "[t]he application of zoning and other land use controls by local government affects land, also known as real property, or more accurately, affects property interest." *Id.*

The notion that zoning constitutes a property right finds support from the legal concept of property as a bundle of rights in a piece of land. CUNNINGHAM ET AL., *supra* note 232, § 1.1. Zoning severs some of these rights from the individual property holder, by regulating the use of its property. Arguably these separate rights are vested in the public, or local government, as the representative of the people. *See generally* NELSON, *supra* (exploring concept of zoning as property right and consequences resulting from removal from private domain).

259. *See supra* note 252. A development agreement vests in the developer an entitlement to the benefits of a specified zoning scheme, and thus a particular use of its property. This entitlement is subject to defeasance, however, in the event of developer noncompliance with the terms of the agreement. In the event of noncompliance, the right to control the use of the property reverts back to the local government. *Cf.* Mayor of Rockville v. Walker, 86 Md. App. 691, 697, 587 A.2d 1179, 1182 (1991) ("[T]he grantor may again acquire [the estate] for breach of the condition under which it was granted.").

260. *See supra* notes 41-52 and accompanying text (describing character of defeasance associated with vested right created by development agreement).

261. *See* FLA. STAT. § 163.3229 (1993) (limiting duration of development agreements, but allowing for renewal period following additional public hearings).

262. *See supra* notes 204, 221 and accompanying text (discussing issue of noncompliance and statutory provision for unilateral termination or amendment by local government).

263. *See supra* notes 41-52 and accompanying text (discussing court's construction of agreement in *Walker*).

264. Mayor of Rockville v. Walker, 86 Md. App. 691, 587 A.2d 1179 (1991). Analogously, the vested right in development is defeasible. *See supra* note 221 and accompanying text (discussing statutory provisions for unilateral termination of agreement in event of developer non-compliance).

right in development, one might construe the conveyance as contingent upon a condition subsequent.[265] This condition would require that the developer complete or contribute the required exaction. The problem with the construction of the development agreement as creating a defeasible property interest, however, is the draconian consequences of default—the property right is extinguished or forfeited in its entirety.[266]

Alternatively, the property interest created by a development agreement resembles something more akin to a real covenant that runs with the land.[267] There are traditionally four requirements for a real covenant: (1) a writing; (2) intent; (3) touch and concern; (4) privity.[268] A development agreement easily passes muster under the first two criteria. First, the development agreement is statutorily memorialized in writing through the passage of an ordinance.[269] The

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265. Most of the literature available on development agreements is addressed to their use as vesting mechanisms, by limiting the government's power to subsequently impact project completion, through the enactment of additional regulatory restrictions. *See* DEVELOPMENT AGREEMENTS, *supra* note 11 (providing numerous essays evaluating and analyzing use of development agreements); Curtin & Zischke, *supra* note 155 (considering overview of development agreements as vesting mechanism). As *Walker* illustrates, however, the development agreement may go even further and act as a transferring mechanism of publicly owned property. *Walker*, 86 Md. App. 691, 587 A.2d 1179; *see also* Hans Mattson et al., *Development Agreements For Residential Development in Sweden*, DEVELOPMENT AGREEMENTS, *supra* note 11, at 91 (discussing use by Sweden of development agreement as property-allotment mechanism by which municipality transfers publicly held land to private developer).

266. *See* CUNNINGHAM ET AL., *supra* note 232, §§ 2.3-2.6.

267. A real covenant is defined as "a covenant the obligation of which is so connected with the realty that he who has the latter is either entitled to the benefit of it or is liable to perform it." BLACK'S LAW DICTIONARY 364 (6th ed. 1990).

While this Article argues that the proper construction of the development agreement is as a real covenant, it acknowledges that the same result could be reached through a unification of servitude and defeasible fees, as propounded by a number of scholars. *See generally* Susan F. French, *Toward A Modern Law of Servitudes: Reweaving the Ancient Strands*, 55 S. CAL. L. REV. 1261 (1982) (attempting to provide modern framework for analyzing covenant and associated types of land use controls); Gerald Korngold, *For Unifying Servitudes and Defeasible Fees: Property Law's Functional Equivalents*, 66 TEX. L. REV. 533, 536 (1988) ("[C]ondition[s] imposed in a defeasible estate and a servitude limiting a fee are methods for transferring from the fee owner to another person a nonpossessory ownership interest in the land burdened by the servitude or condition.") (footnote omitted); Uriel Reichman, *Toward a Unified Concept of Servitudes*, 55 S. CAL. L. REV. 1179 (1982) (discussing different characteristics of and standards applying to equitable servitude, running covenants, and easements, and arguing persuasively that all should be treated as one concept).

268. CHARLES E. CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH THE LAND" 74 (1929).

269. *See supra* note 262 (requiring that covenant comply with statute of frauds and

second requirement of "running" intent may be met by a clear recital and warrant within the covenant that it runs to assignees.[270] Thus the development agreement should include a clause similar to the following:

> *All of the covenants, conditions, and obligations contained in this Agreement shall be binding upon and inure to the benefit of the respective assignees of the parties hereto.*

The final two requirements are slightly more complex. In order for a covenant to run with an estate, it must touch and concern the land.[271] Courts have applied a number of tests in determining what constitutes touch and concern.[272] One test examines whether the covenant increases the value of the landowner's property.[273] This must be determined both in terms of the burden (the promisor) and the benefit (the promisee).[274] Here, the municipality's covenant to freeze the regulatory scheme clearly touches and concerns the real estate developer's property. By vesting the right to develop, the covenant provides a benefit that increases the legal interest the developer holds.[275] It is less clear, however, whether the burden meets the touch and concern requirement. The problem is that the government only promises not to change the applicable land use scheme and, in this respect, the promise from the promisor or burden perspective does not appear to directly affect the value of any property. There are two responses to this, however. The first is that

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other elements rendering it a binding contract between the parties); *see also supra* notes 12, 139, 141, 143 and accompanying text (discussing contractual nature of development agreements).

270. *See* CLARK, *supra* note 268, at 74; *see also* CUNNINGHAM ET AL., *supra* note 232, § 8.16 (stating that careful draftsmen will always include language evincing intent for covenant to run); *cf.* CAL. GOV'T CODE § 65868 (West 1983) (stating that agreement may be amended or canceled by parties to agreement or successors in interest, indicating legislative intent that development agreement is intended to run to assignees).
271. *See* CLARK, *supra* note 268, at 75.
272. The question of exactly what constitutes "touch and concern" is perplexing and unclearly defined. CUNNINGHAM ET AL., *supra* note 232, § 8.15. The test that reflects the modern trend is that the covenant "operate[s] either to make more valuable some of the rights, privileges, or powers possessed by the covenantee or to relieve him in whole or in part of some of his duties." Harry A. Bigelow, *The Content of Covenants in Leases*, 12 MICH. L. REV. 639, 645 (1914); *see also* CLARK, *supra* note 268, at 97-98 ("[If] the promisee's legal relations in respect to that land are increased—his legal interest as owner rendered more valuable by the promise—the benefit of the covenant touches and concerns the land.").
273. *See* CLARK, *supra* note 268, at 76 (adopting Professor Bigelow's legal relations of the parities test for determining whether covenant meets touch and concern requirement).
274. *See id.* at 76.
275. *See supra* notes 232-41, 251 and accompanying text.

it may not be necessary that the burden meet the touch and concern requirement because in the case of the development agreement only the benefit need run for it to be enforceable.[276] In the alternative, one can argue that the burden does touch and concern because it limits the municipality's property right to a particular zoning ordinance.[277] In this case both the burden and the benefit would run and thus, the development agreement would be enforceable as a real covenant.[278]

The final requirement, privity of estate, has held a variety of meanings over time.[279] Today, it is commonly accepted as only requiring a succession to one party's estate.[280] Thus, a lender who forecloses a mortgage and takes title to the developer's property should qualify for privity of estate and be entitled to enforce the agreement.

While to date no court has specifically construed development agreements as real covenants, this seems to be the most appropriate construction. The language found in California's statutory enabling act supports such a construction. It states that "[t]he burdens of the agreement shall be binding upon, and the benefits of the agreement shall inure to, all successors in interest to the parties to the agreement."[281] British commentators' construction of similar statutorily based agreements as real covenants, provides further support.[282] Finally, at least one model development agreement form specifically provides that the provisions of the agreement act as covenants running with the land.[283] The construction of the development agreement as a real covenant, which attaches to the estate of the developer, offers significant benefits in terms of implementation and enforceability

276. *See* CLARK, *supra* note 268, at 80 ("[C]ovenantee's assignee may sue covenantor when the benefit runs . . . .").

277. *See supra* notes 13, 232-51 and accompanying text.

278. *See* CLARK, *supra* note 268, at 80-82.

279. *See id.* at 91-96. Clark outlines three possible requirements of privity. These are: "(1) succession to the estate of one of the parties to the covenant . . .; (2) succession of estate [] between covenantor and covenantee . . .; (3) mutual and simultaneous interest of the parties in the same land . . . ." *Id.* at 91.

280. *Cf. id.* at 91.

281. CAL. GOV'T CODE § 65868.5 (West 1983) (supporting the requisite intent element of real covenants).

282. *See* Stephen Evans, *Practical Aspects of Section 52 Agreements* 128 SOLIC. 181, 182 (1984) (providing general overview of British equivalent of statutory enabling legislation for development agreements and stating that such agreements create covenants running with the land); *see also* Malcolm Grant, *Statutory Development Agreements: The British Experience*, DEVELOPMENT AGREEMENTS, *supra* note 11, at 77, 81-82 (discussing British experience with development agreements and critiquing construction as real covenant).

283. Curtin, *supra* note 146, app. B at 203.

that are appealing to the lender.[284] The primary advantage being that a real covenant is enforceable by and against assignees to the property with which it runs.[285]

Regardless of its actual construction, it is clear that development agreements go further than historical subdivision regulations and conditional zoning because they create property rights.[286] This adds to the bundle of property rights in the developer's estate and therefore increases the value of the estate.[287] The developer realizes this increased value through the elimination of the uncertainty posed by a changing land use regulatory scheme on the real estate development process and the consequently greater likelihood that it will complete the proposed development. By injecting certainty into the development process, the agreement decreases the risks to a financier associated with real estate development. Thus, a development agreement can serve as an effective tool in rendering real estate development more attractive to financial institutions.

B. *Lenders' Concerns Regarding Drafting of Agreements*

Development agreements identify a legal interest in the right of development in property and render that interest a discrete component of the property. The incorporation of that interest as part of the collateral for real estate financing resembles real estate component financing. The lender's concern, in evaluating a loan application predicated on collateral encompassing a development agreement, will in turn parallel many of the same concerns associated with leasehold financing or financing secured by an assignment of rents.[288] As *Walker* indicates, an improperly structured development agreement can pose dire consequences to a lender.[289] Similar to a lease, a development agreement has the power to directly affect the value of the collateral because it directly implicates the developer's ability to

284. *See* CUNNINGHAM ET AL., *supra* note 218, § 8.13 (indicating that primary benefit associated with real covenants is enforceability against "remote" parties in interest).
285. *See id.*
286. *See supra* notes 141, 143 and accompanying text (contrasting conditional zoning, development agreements, and subdivision regulations).
287. *See supra* notes 13, 232-51 and accompanying text (analyzing zoning as collective property right and indicating that right may be transferred to developer through development agreement).
288. *Cf. supra* notes 89-94, 96, 104, 106, 112, 116 and accompanying text (exploring lender concerns in the area of leasehold financing).
289. Mayor of Rockville v. Walker, 86 Md. App. 691, 691-97, 587 A.2d 1179, 1179-81 (construing breach of development agreement, by developer as extinguishing mortgagee's security interest in attendant property).

complete construction in a timely and cost efficient manner.[290] Thus, the lender will closely examine the agreement because the value of the collateral property is predicated on project completion and because, in the event of developer default under the mortgage agreement, the lender may step into the shoes of the developer.

The first step in allaying the lender's concerns is the inclusion of the lender in the original negotiations.[291] This is not always possible, however, and thus the developer and local government should attempt to anticipate the potential concerns of a lender in formulating the initial agreement. While including the lender as a party to the agreement seems similarly attractive at first glance, such inclusion may raise the specter of lender liability and should be approached with caution.[292] Inclusion of the lender as an actual party to the agreement indicates a degree of control over the project that might lead a court to classify the lender as an owner, operator, or partner in the development.[293] The classification may result in lender liability on a variety of grounds. This section provides a discussion of the terms and structure of the agreement which will most heavily impact upon the developer's ability to complete construction.

The lender will closely evaluate the terms of the agreement, seeking to identify any term or condition that will adversely impact

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290. This is analogous to the lender's concerns in financing which are predicated on dedication of income of rents from leases. In such financing, the lender is concerned with terms that will impact on the continued flow of rents. *See supra* notes 89, 96, 104, 106, 112, 116 and accompanying text (discussing such lender considerations as tenant's financial capacity, level of rent, and term of lease that indicate potential for continued flow of income from rents servicing debt). The lender will wish to ensure that the developer will be able to comply with the terms of the agreement, because failure to do so may terminate the agreement, thus extinguishing the vested right in development. *See supra* note 221 and accompanying text (discussing effect of developer noncompliance with terms of agreement). Furthermore, if the development agreement is construed as a running covenant, the developer's default on the loan will place the lender in the developer's shoes. This is analogous to the situation where the developer defaults in leasehold financing, and the lender steps into its shoes as a tenant.

291. *See* Joseph E. Coomes, *Practical Concerns in Drafting and Negotiating Development Agreements, in* DEVELOPMENT AGREEMENTS, *supra* note 11, at 133, 139 (stating that lenders are generally not familiar with benefits of development agreement, but potential impact on lender in event of foreclosure, requires that developer draft an agreement with concern for implications to lender); Evans, *supra* note 282, at 182 (stating that mortgagees should be party to § 52 agreement, which is British equivalent of United States development agreement); *cf. supra* notes 99-101 and accompanying text (discussing importance of inclusion of lender in lease negotiation, which will be used as part of security interest in obtaining financing, but concluding that this may not always be feasible).

292. *See supra* notes 5-6 and accompanying text (discussing lender liability).

293. *See supra* notes 5-6 and accompanying text.

on project completion. First, the lender will seek to ensure that the agreement provides sufficient duration to enable the developer to complete the proposed development as well as any required exaction under the terms of the agreement.[294] A definite duration term also undermines any constitutional attack on the basis that the development agreement violates the reserved powers doctrine and thus, is void.[295] Such a term helps to ensure the agreement's validity.

The exaction on which the agreement is predicated will also be of concern to a lender. The requirements placed on the developer by the exaction place additional costs on the development process.[296] The developer should incorporate these costs into the calculation of its financing needs and take them into account when determining the total costs and value of the project. Furthermore, the feasibility of the exaction's completion should be considered. Central to the enforceability of the development agreement is the developer's compliance with its end of the bargain.[297] Thus, the exaction should not overburden the developer and threaten the success of the project. Clearly, at a minimum, the increased value of the property based on the vested development right should equal the increased costs associated with the exaction. Ideally, the property right created by the agreement will enhance the project's value by more than the costs of the exaction.

The developer's compliance with the terms of the exaction is integral to the continuing existence of the property right created by the development agreement.[298] Thus, the terms that define events constituting breach of conditions of noncompliance and those that

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294. *See* Coomes, *supra* note 291, at 137, 138 (indicating that developer's interest dictates that the agreement provide for the longest term possible, often linked to period of financing, and that present practice is to specify such a term between 10 and 25 years). Without sufficient time to complete the development, the agreement's vesting of development rights is more illusory than real. The lender's concern with the duration of the agreement and the developer's ability to complete the project is analogous to the lender's concerns in leasehold financing as to the duration of the lease. *See supra* notes 99-101 and accompanying text (indicating that insufficient duration of lease term minimizes value of lease as security to lender).
295. *See supra* notes 27, 172, 179 and accompanying text (exploring reserved powers doctrine and application to development agreements). The longer the duration of the agreement, the more likely a court will construe the agreement as an illegal bargaining away of the police power, thus voiding the agreement. Coomes, *supra* note 291, at 138.
296. *See supra* notes 5, 7, 9, 15, 81, 82, 86, 135 and accompanying text (discussing cost of exactions and evaluating who actually bears increased costs).
297. *See supra* notes 24, 220, 236, 240 and accompanying text (discussing remedies and implications of agreement's breach).
298. *See supra* note 221 and accompanying text (discussing effect of noncompliance as termination of agreement and voiding of vested right).

identify corresponding remedies will also be important to the lender.[299] Several statutes already provide for the remedy of specific performance, however, the agreement should expressly identify this remedy.[300] Furthermore, the lender will require that it be given notice of any default by the developer.[301] The development agreement should entitle the lender to cure any defects with the terms of the agreement before allowing the local government to take action amending or terminating the agreement.

The development agreement should expressly delineate the nature of the benefit to both parties. The parties should draft this clause in such a way as to make clear that it touches and concerns the land.[302] This will aid in the development agreement's assignability and construction as a real covenant. The drafter might use such language as:

> *The benefit to Developer under this Agreement consists of the vesting of the right to develop its property according to [reference description of premises annex], and exempting the development from application of any subsequently enacted incompatible regulations or ordinances.*

Furthermore, the agreement should clearly identify the applicable regulations and ordinances in effect at the time of the agreement.[303] Such a delineation might be encompassed in an annex to the agree-

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299. *See* Coomes, *supra* note 291, at 145-46 (stating that agreement should comprehensively address requirements of annual review provision and issue of default, remedies, and termination of agreement).

300. *See supra* notes 220-21 and accompanying text (delineating statutorily delineated remedies); *see also* Coomes, *supra* note 291, at 145 (identifying specific performance as preferred remedy).

301. *See* Coomes, *supra* note 291, at 145 ("All parties should receive notice of review and opportunity to respond to any charges that might lead to default."); *cf. supra* notes 89, 96, 104, 106, 112, 116 and accompanying text (noting that lender will require such notice and opportunity to address issue of default within context of subdivision regulation exactions).

302. *See supra* notes 264-70 and accompanying text.

303. *See* Coomes, *supra* note 291, at 140-41 (discussing importance of precision in delineating extent of rights which vest). This is similar to the lender's concern with operating covenants in the area of leasehold financing. *See supra* note 105 and accompanying text (discussing lender concern with operating covenants of lease, as impacting on value of lease). As has already been indicated, the regulatory scheme is only frozen as to the regulations delineated by the agreement. Any subsequent regulations which do not directly conflict with the delineated terms of the agreement, are enforceable against the developer. *See supra* note 218 and accompanying text (providing statutory basis for this conclusion); *see also* Fitzgerald & Peiser, *supra* note 31, at 43-44 (discussing problems resulting from Colorado Place development agreement, and subsequent renegotiation of terms of agreement, despite developer contentions that proposed development was authorized by terms of initial agreement).

ment, but should be clearly referenced within the agreement itself. The more specific and detailed the agreement, the less opportunity there will be for subsequent dissent over the governing land use scheme.

As has already been noted, the developer should encourage the lender's input during negotiations to ensure that the agreement is drafted in a manner consistent with the lender's concerns. This leaves open the question of whether the parties to the agreement should solely consist of the developer and municipality or whether other parties should be joined. Wherever possible, it is advisable to include all third party governmental or quasi-public bodies that might wield regulatory power affecting the development.[304] This would include state and federal agencies such as coastal commissions or environmental protection groups. Without the inclusion of such bodies as parties to the agreement, the regulatory freeze provision may be ineffective in ensuring the developer's right to develop because the developer will be subject to any subsequent regulatory requirement promulgated by such a group.[305] The case of *Avco Community Developers v. South Carolina Regional Commission*[306] illustrates such a scenario. In *Avco*, even if the developer and local government had entered into a development agreement, the failure to join the California Coastal Zone Conservation Commission, a state agency, to the agreement would have been fatal to the developer's project.[307] The fact that state enabling statutes provide that any such agreement is subject to amendment in order to comply with any subsequent state or federal law, or regulation reinforces this point.[308] While

304. *See* Marsh, *supra* note 187, at 159 (proposing that development agreements be used in multi-agency/multi-interest developments). Marsh uses the example of the San Bruno Mountain Habitat Conservation Plan Agreement to illustrate the desirability and mechanics of multi-agency agreements. *See id.* at 160-62 (stating that parties to this agreement included "three cities, a county, two state park and wildlife agencies, the federal wildlife agency, and a number of landowners and developers.").

305. *See* Coomes, *supra* note 291, at 142 (identifying potential enactment of state or federal law or regulation that interferes with vested right as problematic from developer's viewpoint, and stating that developer may require ability to negotiate with or seek other manner of complying with regulation, thus avoiding automatic voidance of agreement).

306. 553 P.2d 546 (Cal. 1976), *cert. denied,* 429 U.S. 1083 (1977).

307. *Id. See also* Marsh, *supra* note 13, at 3.

308. *See* CAL. GOV'T CODE § 65869.5 (West 1983) (providing for modification or suspension of agreement in event of preemptive law by federal or state legislation); FLA. STAT. ANN. § 163.3241 (West 1994). For a case illustrating the potential impact which federally enacted legislation may have on the development process, see Board of County Supervisors of Prince William County v. United States, 23 Cl. Ct. 205 (1991) (evaluating claim of developer to vested right of development under local rezoning preempted by enactment

inclusion of all regulatory bodies is encouraged, it is not necessarily fatal to the success of the agreement. This is true for two reasons. First, the bulk of zoning and land use regulation is primarily a function of local government, thus the municipality is still the primary party that the developer should seek to bind.[309] Second, if the development agreement is viewed as creating and conveying a property right, as posited in this Article, one can argue that the application of *any* post agreement regulation to the project affects a taking of this property interest and is thus subject to takings analysis.

One final concern to the lender is the extent to which the property right created and conveyed by the development agreement inures to the developer's estate and thus becomes assignable to subsequent holders of the estate. An assurance of assignability and the closely related concept of enforceability is essential in the event the developer subsequently defaults on the loan, forcing the lender to intervene and take title to the property. The final section of this Article addresses this need for assignability and enforceability of the development agreement as an essential attribute in rendering the agreement a viable financing device.

C. Assignability and Enforceability of the Development Agreement

In order to ensure the effectiveness of the development agreement in protecting all of the relevant parties' interests, a viable enforcement and assignment mechanism must be provided. This is most efficiently accomplished through a construction of the development agreement as a real covenant. The advantage of this construction is that the covenant attaches to the developer's estate and thus is enforceable by and against subsequent assignees of the property.[310]

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of the Manassas National Battlefield Park Act, 16 U.S.C. § 429(b) (1988), which provided for eminent domain proceeding over developer's property). The court in *Prince William* specifically stated that the zoning ordinance was not enforceable against the United States. *Prince William,* 23 Cl. Ct. at 209 n.2.

309. *See* HAGMAN & JUERGENSMEYER, *supra* note 20, § 3.6.

310. *See* CUNNINGHAM ET AL., *supra* note 232, § 8.13 (contrasting the difference between a pure contractual covenant and a real covenant. Real covenant rights and benefits do not require express assignment, but rather travel with land or estate, and thus bind remote parties who acquire interest in burdened and benefitted land); Coomes, *supra* note 291, at 19 (contrasting developer's wish to ensure assignability of agreement, with local government's concern with effect of unfettered assignability and concluding that any restraints on alienability must be rationally related to public objective); *see also* Curtin & Skaggs, *supra* note 193, at 127-29 (evaluating application of doctrine against restraints on alienation as applied to development agreements, and indicating that limited interest created may not be subject to doctrine, but also stating that legislative intent seems to link agreement to land and indicate intent that agreement be transferable).

If the agreement is used as an instrument to secure the financing for the proposed project, the rights under the agreement must be assignable to the lender. This is because the essential value of the development agreement is its conveyance of a property right in development, which in turn provides for greater certainty and predictability in the construction process and completion of the project. Thus, in the event of foreclosure or a deed in lieu of foreclosure, assignability will enable the lender to realize the full value of the collateral.[311] In addition, if the lender opts for a workout, regardless of whether it is with the original developer or someone else, it is assured that development will proceed according to plan without the imposition of new or changed land use restrictions.

The agreement must be structured so that it complies with the relevant common law requirements for enforcement as a real covenant.[312] The development agreement should include clear warranties and recitals that it acts as a real covenant. Thus, the agreement should clearly identify the benefit to be provided as well as the assignable nature of the right bestowed.[313] Furthermore, the agreement should be recorded and made public as an encumbrance on the title.

The agreement might also include a provision similar to an attornment clause used in assignment of rents financing.[314] Such a clause would consist of an agreement by the municipality to allow the lender to enforce the agreement against it. Thus, the agreement might contain language similar to the following:

> *[The municipality] agrees that if the interest of the Developer in the Premises are transferred or assigned to the Lender by reason of foreclosure or other proceedings brought by it (for purposes of this paragraph, the term "Lender" shall be deemed to include any grantee of lender or purchaser at foreclosure sale), [the municipality] shall be bound to Lender under all of the terms, covenants, and conditions of the Agreement for the duration thereof. [The municipality] does hereby attorn to Lender, as developer, said attornment to be effective and self-operative without the execution of any*

311. *See supra* notes 89, 117-36 and accompanying text (discussing lender options and issues of concern in event of borrower default and stressing that developer will do everything in its power to complete development).
312. *See supra* notes 259-72 and accompanying text (delineating common law requirements of real covenants and evaluating development agreements ability to conform to requirements).
313. *See supra* notes 259-72 and accompanying text.
314. *See supra* notes 89, 96, 104, 106, 112, 116 (identifying attornment and nondisturbance provisions as potential clauses required by lender in lease).

further instruments on the part of any of the parties hereto immediately upon Lender succeeding to the interest of the Developer in the premises.[315]

The lender's interest in ensuring the inurement and assignability of the agreement may conflict with the local government's desire to maintain some degree of quality control over the project's development.[316] This need not necessarily be a stumbling block because the local government's interest in an efficiently completed, high quality development project, substantially coincides with the lender's interest in completion.[317] The lender, itself, will act as assurance that the project will be completed under the terms of the agreement.

In conclusion, it is clear that if the development agreement is to serve as a financing mechanism for real estate development, the property right created must inure and be assignable with its corresponding estate. The most viable mechanism for accomplishing this is for the development agreement to be drafted and treated as a real covenant, thus rendering it enforceable by subsequent assignees of the developer, including the lender in the event of foreclosure or a deed in lieu of foreclosure.

VI. CONCLUSION

The real estate development process is one fraught with risk to the unwary lender. An increasingly complex regulatory process poses one of the chief threats to a project's completion. Failure to complete a project may substantially impair the value of the property serving as collateral as well as deprive the developer of the means with which to repay the lender. Development agreements, by creating and conveying a vested right in development, inject a greater degree of

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315. *Cf.* Welborn, *supra* note 107, at 26-32 (providing model attornment provisions, from which this proposed language is adopted).

316. *See* Curtin & Skaggs, *supra* note 193, at 127-28 (indicating that municipality may be reluctant to allow for free transferability of agreement by developer, motivated by desire to maintain some control over who develops project, and protect development from unreliable developer).

317. The lender's primary concern will be an efficient and proper completion of the proposed development, because this may very likely be the only way in which it may recover its loan. *See supra* notes 77-78 and accompanying text (discussing lender's interest in project completion in avoidance of material impairment of collateral). Furthermore, the lender may face liability for an improperly completed building, and thus will wish to insure proper completion. *See supra* notes 5-6 and accompanying text (discussing lender liability under common law tort doctrine).

stability and predictability into a typically unstable process. The property right conveyed by the agreement should provide an added incentive to a lender's involvement in the real estate financing process. The agreement conveys a property interest in development, increasing the value of the collateral that is available to secure financing. In order for the development agreement to effectively accomplish this, it is essential that the agreement be structured in such a fashion as to address the lender's concerns. This Article identifies some of these concerns and provides a general outline of the issues that the parties should address in the development agreement. Finally, this Article asserts that the development agreement may best accomplish this purpose through its construction as a real covenant, thus providing for enforcement and assignability to the lender and subsequent assignees.