Development Agreements - All You Need To Know For Successful Development

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INTRODUCTION

Cities are more and more being asked to enter into development agreements with developers for development projects. Although development agreements may encourage and enable much needed development throughout the state, they also can lock cities into a particular development proposal far into the future with potential negative consequences on the locality. This paper explores the development agreement statute and discusses options for protecting cities in the negotiation of development agreements.

A development agreement is an agreement between a property owner and a city or county, whereby certain development rights are "frozen", providing assurances to the developer that it will be able to develop a project at a future date in accordance with the regulations in place at the time the project is approved. Unless otherwise specified in the development agreement, the land use regulations and policies in place at the time the agreement is entered into are the ones that will apply to the development of the property that is subject to the development agreement. (Gov't Code Section 65866(a).)

VESTED RIGHTS

Development agreements are a statutory response to California's common law vested rights doctrine designed to mitigate the impact on development of late vesting rights. California case law only vests development rights when a property owner has performed substantial work and incurred substantial liabilities. The late vesting of development rights was seen as a deterrent for developers to invest in large scale developments that could take several years to complete because of the risk that prior to completion, land use laws could be changed such that the development entitlements would be withdrawn. Development agreements introduced a level of certainty to the development process by freezing the land uses applicable to a project to those in effect at the time the development agreement becomes effective. Development agreements are a powerful tool to encourage development and have proved popular with both cities and developers.

In adopting the development agreement statutes in 1979, the Legislature found and declared that "lack of certainty in the approval of development projects can result in a waste of resources, escalate the cost of housing and other development to the consumer, and discourage investment in and commitment to comprehensive planning" and that "[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, will strengthen the public planning process, encourage private participation in comprehensive planning, and reduce the economic costs of development." (Gov't Code Section 65864(a)-(b).) The development agreement statutes are intended to provide that development certainty.

In order to understand the power of development agreements and why developers request cities to enter into one , it is important to understand the vested right doctrine.

a. The Avco Rule

A project's approvals may be vested under the common law vesting doctrine, also known as the "Avco Rule" regardless of whether the permits have expired or land use controls have changed. (*See Avco Community Developers, Inc. v. South Coast Regional Com.* (1976) 17 Cal.3d 785.) Under the Avco Rule, if a property owner has "performed substantial work and incurred substantial liabilities in good faith reliance upon a permit issued by the government," then the property owner has a vested right to complete the project in accordance with the original approvals, notwithstanding other local laws or regulations to the contrary. (*Id.* at 791.)

i. Nature of the Permit

The Avco Rule simply states that "a permit issued by the government" is required for vesting, but it does not directly address what form of permit is required. (*Id.*) Although many cases require that a building permit must be obtained for the Avco Rule to apply, some California Courts of Appeal have suggested that "a vested right might arise before the issuance of a building permit if the preliminary permits approve a specific project and contain all final discretionary approvals required for completion of the project." (*Billings v. California Coastal Com.* (1980) 103 Cal.App.3d 729, 735; quoting *Raley v. California Tahoe Regional Planning Agency* (1977) 68 Cal.App.3d 965, 975, fn. 5.) The California Supreme Court has not ruled definitively as to whether a building permit is required or if another form of final approval may satisfy the Avco Rule; it has resolved cases regarding vesting claims on other grounds without explicitly permitting or prohibiting approvals other than building permits to support a claim of vested rights. (See *Pardee Construction Co. v. City of Camarillo* (1984) 37 Cal.3d 465; *Santa Monica Pines, Ltd. v. Rent Control Board* (1984) 35 Cal.3d 858.) To resolve a case regarding vested rights under California law brought in federal court, the Ninth Circuit assumed that "sufficiently detailed special use permits" would satisfy the Avco Rule. (*Lakeview Dev. Corp. v. South Lake Tahoe* (9th Cir. 1990) 915 F.2d 1290, 1298.)

ii. Substantial Work and Substantial Liabilities in Good Faith Reliance on the Approval

A property owner must have "performed substantial work and incurred substantial liabilities in good faith reliance upon a permit issued by the government" before acquiring vested rights to develop. (*Avco Community Developers, Inc.*, 17 Cal.3d at 791.) Soft costs to obtain project approvals or to prepare for construction are insufficient to create vested rights; "hard costs" towards completing physical construction are necessary. (*Hermosa Beach Stop Oil Coalition v. City of Hermosa Beach* (2001) 86 Cal.App.4th 534, 552.) Even once construction has started and substantial liabilities have been incurred, vested rights do not attach to a project unless the property owner acts in good faith to "expeditiously" proceed with the development. (*Lakeview Dev. Corp.*, 915 F.2d at 1298.) As a limiting factor to the Avco Rule, the California Supreme Court held that "[t]he rights which may "vest" through reliance on a government permit are no greater than those specifically granted by the permit itself." (*Santa Monica Pines, Ltd.*, 35 Cal.3d at 866.) This means that a property owner cannot claim a vested right for a particular project "when the project temporally exceeds the scope of that approved" and that project approvals are "necessarily conditioned on the developer's proceeding at a pace reasonably close to that contemplated at the time the project was approved." (*Id.*)

In *Lakeview*, the developer applied for and received a subdivision map and a special use permit for a two-phase residential development and a hotel. (See *id.* at 1291.) The approval contemplated a three- to six-month time frame between the completion of phase one and phase two. (*Id.*) The developer completed phase one on schedule, then proceeded with the hotel development, which took several years to complete because of changing market conditions and financing issues. (See *id.* at 1293.) The developer waited ten years from the completion of phase one – twelve years from receiving its original approval – to request building permits for phase two. (See *id.* at 1298.) The court reasoned that the city and the developer did not foresee that phase two would remain undeveloped for so long, and the long break between phases indicated that the expenditures the developer made to develop phase one and the hotel could not have been made in reliance on the ability to have a vested right to complete phase two. (*Id.*)

California's common law vested rights doctrine makes development in uncertain times more difficult and could deter developers from incurring the initial costs needed to bring a development to fruition. A development agreement in its most simple form is intended to address this issue by providing certainty but since the development agreement statutes were adopted and development agreement have become more ubiquitous, the scope of development agreements has also expanded, sometimes to the benefit to cities and sometimes to their detriment.

GOVERNMENT CODE PROVISIONS FOR DEVELOPMENT AGREEMENTS

The California Government Code lays out specific requirements that must be included in a development agreement. We will identify the requirements here and later in the paper will discuss some additional considerations when negotiating and drafting a development agreement.

a. <u>Parties</u>.

In many instances, a development agreement is initiated by a project applicant and some jurisdictions have a specific application form or process for a project applicant to request a development agreement. As part of the application review process, it will be important to understand who will be entering into the development agreement with the city. A person entering into a development agreement with a city or county must have a legal or equitable interest in the real property. (Gov't Code Section 65865(a).) The interest in the real property is important, as the development agreement will be recorded on title to the property and thus the entity entering into the agreement must have an interest in the real property that allows for such recording. Often cities are asked to negotiate the development agreement prior to the developer obtaining title to the property. The developer may either have an option to acquire the property or a purchase and sale agreement with the property owner. Although an option or a purchase agreement can constitute an interest in the property sufficient for purposes of the development agreement statute it is advisable to obtain the property owner's consent before negotiating since the terms of the agreement can have an impact on the property.

b. Content.

The Government Code specifies certain requirements of what must be included in the development agreement. In particular, the agreement must specify the duration of the agreement, the permitted use of the property, the density or intensity of use, the maximum height and size of the proposed buildings, and provisions for reservation or dedication of land for public purposes. (Gov't Code Section 65865.2.) The development agreement additionally may, but is not required to include conditions, terms, restrictions, requirements for subsequent discretionary actions, and conditions relating to applicant financing of necessary public facilities or reimbursement over time. (*Ibid.*) While these are not considered requirements under the development agreement statutes, it is good practice to include this information. If the development agreement includes a subdivision that will include development of more than 500 dwelling units (or in the case of a public water system with fewer than 5,000 service connections an increase of 10 percent or more in the number of existing service connections) the development agreement must provide that any tentative map prepared for the subdivision will comply with Government Code Section 66473.7, which requires a condition of approval that sufficient water supply is available. (Gov't Code Section 65867.5.) Another topic that is a good practice to include is procedures for subsequent approvals and whether any land use regulations or policies will not vest through the development agreement. (Gov't Code Section 65866(a).)

c. Approval Procedures and Monitoring.

Development agreements are legislative acts and approved by ordinance. (Gov't Code Section 65867.5.) As such, they must follow general procedures for the adoption of a land use ordinance. A public hearing before the planning agency (the planning commission in most jurisdictions) and then the legislative body must be held. A notice of intention to consider the adoption of a development agreement must be given prior to the public hearings in accordance with Government Code Sections 65090 and 65091. (Gov't Code 65867.) This notice involves publication in a newspaper of general circulation or posting the notice in three public places at least ten days before the hearing date, mailing to specified property owners and agencies at least ten days before the hearing date, and any other public hearing procedures adopted by the local jurisdiction. As part of the approval process, the city must make findings that the provisions of the agreement are consistent with the general plan and any applicable specific plan. Additionally, if any amendment is made or if the agreement is cancelled in whole or in part, by mutual consent of the parties (or their successors), notice of intention to amend or cancel any portion of the agreement, must be made as provided in this paragraph and follow the same procedures for approval. (Gov't Code Section 65868.)

Once a development agreement has been approved, it must be recorded on title to the property within ten (10) days. (Gov't Code Section 65865.5.) This provides record notice of the development agreement, as the burdens of the agreement are binding on all successors in interest to the parties of the agreement.

After the development agreement is adopted and goes into effect, there must be periodic review, at least every 12 months, to demonstrate that the developer is in good faith compliance with the terms of the agreement. (Gov't Code Section 65865.1.). If the local agency finds on the basis of substantial evidence that the applicant is not in compliance with the terms or conditions of the agreement, the local agency may terminate or modify the agreement. (*Ibid.*) The procedures for the periodic review may be included in the development agreement or in the city's local ordinance on development agreements.

d. Other Considerations.

The Government Code lays out several additional items that may not be applicable in all development agreement contexts. A city must, upon the request of an applicant, establish procedures and requirements for the consideration of development agreements. These may be established by resolution or ordinance and the city may recover the direct costs associated with establishing such procedures and requirements. (Gov't Code Section 65865(c)-(d).) Many cities have already adopted such procedures and requirements.

A city may enter into a development agreement with a project applicant that proposes a project for a property that is in unincorporated territory if the property lies within the city's sphere of influence. The agreement, however, cannot become operative unless annexation proceedings to annex the property to the city are completed within the time period specified in the agreement. If such annexation does not occur in the specified time period, the development agreement is null and void. (Gov't Code Section 65865(b).)

As mentioned above, development agreements are approved by ordinance, which is a legislative act. This means that a development agreement is subject to referendum. (Gov't Code Section 65867.5.). Referendums are a process by which voters may weigh in on laws that have been passed by their elected representatives and suspends operation of the law until it has been approved by a majority of voters.

Lastly, the development agreement statutes apply to charter cities (Gov't Code Section 65867.5(d).) Caselaw has also confirmed this. (See *Center for Community Action & Environmental Justice v. City of Moreno Valley* (2018) 26 Cal.App.5th 689.)

BENEFITS OF DEVELOPMENT AGREEMENTS FOR DEVELOPER

Development agreements offer benefits for both the developer and the city. For the developer, the most obvious benefit is the certainty of the rules that will govern the development. Development agreements provide developers of large scale multi-phased projects with certainty that investment in the early phase of the project will not be wasted due to a change in city laws, policies or politics.

a. Development Agreement Vested Right.

As noted above, Government Code Section 65866 freezes the rules, regulations and official policies governing permitted use of the land, density, design, improvement and construction standards to those in place at the time of execution of the development agreement. By freezing the rules governing development, the development agreement statute eliminates the uncertainty caused by the common law vested rights doctrine.

It should be noted that not all rules, regulations and official policies must be frozen by the development agreement. Government Code Section 65866 is clear that the policies and regulations governing land uses, density, design, improvements and construction standards are frozen unless otherwise provided by the development agreement. Thus, as part of negotiating the development agreement, the city and the developer can establish the parameters for which policies and procedures are frozen to benefit the developer.

b. Fees.

Many development agreements go beyond the list of rules and policies in Government Code Section 65866 and include within the regulations frozen, impact and permit fees or provisions that limit the increases in those fees. Freezing permit and impacts fees provides developers with the benefit of understanding the financial costs of completing the development before commencement and eliminates the surprise of new impacts fees. Given that impact fees often increase more rapidly than inflation and new impacts fees can be common, this limit on impact fees can provide a significant monetary benefit to developers, particularly if the development agreement term is lengthy.

c. Extended Term of Permits

Development agreements may extend the duration of permits, approvals and maps to the term of the development agreement, giving developers additional time before commencing development and eliminating costs associated with obtaining approval of extensions.

d. CEQA Certainty

Development agreement often include provisions that the CEQA review for the approval of the development agreement will serve as the CEQA review for all subsequent approvals related to the project unless CEQA requires further analysis. Technically, these provisions may not provide much benefit to a developer since whether additional CEQA review is necessary will be governed by CEQA. But the inclusion of such provisions does limit cities from requiring environmental analysis of subsequent approvals that may not be required under the CEQA statute but that the city or the members of the public believe is necessary.

e. Public Input and Participation

Depending upon the initial approvals granted at the time the development agreement is entered into, discretion for subsequent approvals may be limited, having the effect of limiting the impact of public input for those approvals. The need to participate in lengthy and time-consuming public hearings and meetings for each approval for a development project can delay project development as well as result in unforeseen costs. Development agreements, by freezing the land use policies in place at the time of execution of the agreement, limit policy makers options with regards to subsequent approvals, providing faster and less controversial processing of the subsequent approvals. Some development agreement may also set out the procedures for subsequent approvals, allowing for some approvals to be handled administratively, providing even greater benefits for the developer.

BENEFIT OF A DEVELOPMENT AGREEMENT TO THE CITY

Although the primary purpose of development agreements is to provide developers with certainty of the ability to proceed with a project once approved, there are benefits of a development agreement for cities as well. In addition to providing avenues for development of large-scale projects that provide benefits to the city, development agreements also give cities more regulatory flexibility, allowing for the negotiation of additional public improvements or community benefits.

a. <u>Flexibility and Ability to Shape Projects</u>

Development agreements give cities flexibility to shape development projects in a manner that may not be possible through a standard permit process. By negotiating the density, design and layout of a development, a city may shape the development to meet the city's planning goals in ways that application of a standard zoning ordinance may not allow or encourage.

b. <u>Fees.</u>

Fees imposed by development agreements are specifically exempt from the Mitigation Fee Act (Gov't Code Section 66000(b)). This exemption from the Mitigation Fee Act gives cities the latitude to negotiate additional fees that may not be directly related to the impacts of the development, including fees for community benefits such as recreational programs, job training programs, and other programs that provide benefit to the community as a whole but for which meeting the nexus requirements of the Mitigation Fee Act can be a challenge.

c. <u>Public Improvements</u>

Cities have used development agreements to require developers to pay for public improvements that might provide benefits not just for the development but for the greater community. Because the development agreement is a negotiated contract that a developer voluntarily enters into, the fear of a claim for a regulatory taking is diminished with the use of a development agreement. Examples often include park improvements that go beyond the standard level or size of park, additional roadway improvements including additional landscaping and contributions of land or money for public facilities such as fire stations, police stations and community centers. In addition, through a development agreement, a city can require the completion of these public improvements faster than might occur as a condition of approval thus ensuring that facilities and services are available to the development when the first users arrive rather than the last, which is more common.

DRAFTING DEVELOPMENT AGREEMENTS

Care should be taken in drafting development agreements. Most development agreements have a term that continues beyond the term of the city council that approves the development project and some development agreements may have terms that exceed 15 or 20 years. Given that a development agreement locks in certain land uses and design standards it is important that the agreement reflect the city's goals for the development throughout the development process and if possible, preserve some flexibility for the city to adapt the development to changing circumstances.

a. Project Definition and Vesting.

The most powerful aspect of a development agreement is the ability to freeze land uses to those in place at the time the development agreement becomes effective. Most development agreements incorporate the language of Government Code Section 65866 into provisions granting the developer vested rights to develop the proposed project. However, without a clear project definition, exactly what rights are vested may become subject to dispute as the development agreement is implemented. Often the development agreement will vest the rights granted to the developer pursuant to specifically referenced entitlements, without defining what development is allowed under those entitlements. Review of the entitlements and conditions of approval is crucial in order to draft the development agreement to ensure that the city obtains the development it bargained for. Language in entitlements allowing construction of "up to" a maximum number of residential units or specifying the maximum square footage of open space but not a minimum may mean that the developer can decrease the number of residential units or the size of parks and open space and still be within the rights vested in the development agreement even though the city approved the project on the basis of a certain numbers of square feet of open space or a certain number of residential units. One way to address this is to provide a range, limiting both the minimum number of units or square footage and the maximum. This reduces the flexibility the developer may have to make changes to the development project without being required to amend the development agreement.

b. Applicable Laws/Application of new laws.

Because development agreements can freeze the land uses, density, design and construction standards to those in place as of the effective date of the development agreement it is important for the development agreement to specifically identify the applicable laws. Most development agreements list such things as the general plan, the city municipal code in effect at the effective date and all other city codes, resolutions and ordinances. Without further clarification, newly adopted city resolutions and ordinances that are consistent with the development project that provide benefits to the city or promote citywide policies cannot be applied to the project.

A development agreement should include provisions for the application of new city laws that do not conflict with the development project. In order to make such a provision less likely to result in future disputes between the city and the developer, provisions on what it means to conflict with the development should be included. These provisions may address specific aspects of the project or be more general. Often these provisions will include some quantifiable standards for determining if a new city law conflicts with the development project – for example, if the application of the new city law would reduce the density of the development by an agreed upon percentage or increase the costs of the development by a specific amount or percentage.

Cities will also want to reserve the authority to apply new construction codes to development. As cities continue to adopt new construction codes designed, for example, to address the impacts of climate change and conserve resources, it is important that these provisions can be applied to development that may be approved prior to the advancement of technology or the widespread availability of techniques that are better for the environment.

Finally, it is important that the applicable laws that are frozen be preserved so that as the development agreement ages, staff can refer back to the applicable provisions. Some development agreements attach as an exhibit the full municipal code in effect at the time of approval, however this may be cumbersome for recording purposes. Other development agreements may require that a copy of the existing codes, regulations, and policies be compiled and retained on file.

c. Term.

One of the most heavily negotiated provisions of a development agreement is often the term. Developers will of course want the longest term, arguing that for developments that may be multi-phased they need the opportunity to weather economic cycles. The term of each development agreement is dependent upon the size and type of development covered by the agreement and the expected schedule for development. Developers are reluctant to propose a schedule for fear of being held to the schedule, but it is important for the city to have a proposed schedule to determine what a reasonable term is for the development agreement.

In considering the term of a development agreement, cities will want to look at the proposed schedule as well as how delays in the project will impact city benefits provided by the development.

d. Force Majeure

Closely related to the term is force majeure language. Most development agreements will include standard force majeure language that grants extensions of time for performance by the parties in the event of circumstances beyond the parties' control. Often developers will request additional force majeure protection for economic downturns. There are several disadvantages to cities to allowing an economic force majeure provision. First, it is hard to quantify what constitutes an economic event that prevents development versus a slow down that may make development less economically advantageous to a developer but still feasible. Second, true economic downturns can delay a development project for an extended period of time resulting in a development agreement term extending well beyond the original expected period for performance. If considering an economic force majeure provision, it is advisable to consult with a knowledgeable real estate economist and to run some scenarios of the length of the delay using whatever quantifiable standard is agreed to so that the city has some idea of what the potential period of time for delay could be. And of course, some economic events are unforeseeable such as the 2008 great recission so trying to anticipate all events is impossible.

e. Fees/Taxes

Whether a development agreement freezes or limits impacts fees is usually a heated topic of negotiation. For cities, freezing fees at the level when the agreement is drafted can severely constrain municipal resources once the development is actually constructed. Some development agreements do not freeze fees but rather limit the amount by which fees can be increased each year. Other development agreements may freeze fees only for a limited amount of time to create an incentive for the developer to begin construction on the development project earlier in the development agreement term. In considering provisions related to limitations on fees it is important to make sure that the agreement is clear on which fees may be limited – just impact fees or impact fees and processing fees. Since permit processing fees are designed to cover city costs, cities should avoid placing any limitations on processing fees.

If existing impact fees are to be limited by the development agreement, the agreement should also address whether the development project is subject to any newly adopted impact fees. Often developers will want to limit cities abilities to assess new impact fees or limit the application of new impact fees only to those that are applicable citywide to all similar projects. Similar consideration needs to be made with respect to the application of new taxes and assessment imposed by the city.

f. Subsequent Actions

Development agreements often include language about how subsequent project approvals will be handled. Developers are looking for streamlined processes for subsequent approvals, including limitations on CEQA review, as discussed above. Cities should consider whether allowing administrative approval of some subsequent actions is beneficial to the city given that often, the city's discretion is limited. Along the same line, cities should consider whether any modification to the project and/or the development agreement are considered minor and can be approved at the staff level and which types of modifications would require approval by the planning commission or city council.

g. Survival

A city may desire certain provisions of the agreement survive termination. An example of this may be an indemnification provision or developer obligations that may be long term. Another example is if a service is to be provided as a community benefit, the city may desire this service be continued beyond the term of the development agreement. In some instances, it may make sense to enter into a separate agreement to address these obligations. Items that survive termination should be specifically identified in the development agreement as surviving termination. It may help future reviewers of the agreement if there is a section that identifies all the provisions that survive, in addition to specifying within each particular section.

h. Multi-Phase Projects

In multi-phase projects, a city and developer may want to address what happens to parcels after they have been developed and obligations with respect to that phase of development have been met, or remain ongoing. One such consideration is if a phase of the project is developed and that parcel or parcels are sold, does the development agreement remain on title and become an obligation of the successor in interest, or is that parcel released from the agreement. This may depend on the obligations laid out in the agreement and whether any are intended to continue beyond the completion of a phase of the project.

i. Community benefits

As noted above, development agreements provide an opportunity for cities to negotiate community benefits that the city may not otherwise be able to impose on the project as a condition of approval. The development agreement should be specific as to the community benefits to be provided including the timing for the community benefits to be implemented. The goal should be to ensure that the community benefits are provided as the development is constructed rather than at the end of the development.

CONCLUSION

As described throughout this paper, development agreements provide certainty to developers that they will be able to develop their project as anticipated. Many benefits are provided to the developer, but development agreements also provide an opportunity for cities to receive benefits, as well and the agreement can be mutually beneficial to both parties. Achieving those benefits requires careful drafting and recognition that a one size fits all approach may not be in the best interest of the city.