Advisory Opinion #31

Parties: Ivory Development, LLC and City of Draper

Issued: February 28, 2008

TOPIC CATEGORIES:
D: Exactions on Development
R(vii): Other Topics (Development Bonds)

Warranty bonds are development exactions, and they are subject to rough proportionality analysis. It is unjust to force Developer to pay for damage caused by normal use simply because it occurred within the warranty period, when, at any other time, the damages would otherwise be borne by the public. A subdivision bond might be enforceable under contract law because Developer voluntarily entered into the agreement.
NOTE: Since this Opinion was issued, new provisions of the Utah Code were adopted which govern warranty bonds.

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OFFICE OF THE PROPERTY RIGHTS OMBUDSMAN

ADVISORY OPINION

Advisory Opinion Requested by:	Ivory Development, LLC by Kevin Anderson, Attorney
Local Government Entity:	Draper City
Applicant for the Land Use Approval:	Ivory Development, LLC
Project:	Residential Subdivision
Date of this Advisory Opinion:	February 28, 2008
Opinion Authored By:	Elliot R. Lawrence, Attorney, Office of the Property Rights Ombudsman

Issues

May a local government require security for completion of public improvements and also require a developer to repair any damage to public improvements during the warranty period of a development bond, regardless of the cause of the damage?

Summary

The City's requirement that a developer provide security to ensure completion of public improvements and warrant those improvements against damage is a valid condition under § 10-9a-509(e). That requirement is also an exaction, because it is required in order to obtain approval for a subdivision. It must therefore be analyzed using the "*Nollan/Dolan*" rough proportionality test found in § 10-9a-508(1). There is an essential link between the security and warranty requirement and the City's legitimate interest that public improvements be properly installed. The warranty/repair requirement must also meet the "rough proportionality" prong of § 10-9a-508(1)(b). Each damage repair request must be shown to be roughly proportional to the impact of the subdivision. The City may require repairs to damage caused by the developer, or which is attributable to a design or construction flaw, but not for damage resulting from normal wear, or which is not caused by the developer. However, the City and a developer may enter an agreement whereby the developer agrees to repair all damage.

Review

A request for an advisory opinion may be filed at any time prior to the rendering of a final decision by a local land use appeal authority under the provisions of §13-43-205 of the Utah Code. The opinion is meant to provide an early review, before any duty to exhaust administrative remedies, of significant land use questions so that those involved in a land use application or other specific land use disputes can have an independent review of an issue. It is hoped that such a review can help the parties avoid litigation, resolve differences in a fair and neutral forum, and understand the relevant law. The decision is not binding, but, as explained at the end of this opinion, may have some effect on the long-term cost of resolving such issues in the courts.

The request for this Advisory Opinion was received from Ivory Development, LLC on December 13, 2007. A letter with the request attached was sent via certified mail, return receipt requested, to Kathy Montoya, Draper City Recorder, at 1020 E. Pioneer Rd., Draper, Utah 84020. The return receipt was signed and was received on December 20, 2007, indicating that the City had received it. A response was received from Draper City on January 9, 2008.

Evidence

The following documents and information with relevance to the issue involved in this advisory opinion were reviewed prior to its completion:

1. Request for an Advisory Opinion received December 13, 2007 by the Office of the Property Rights Ombudsman, prepared by Kevin Anderson attorney for Ivory Development, LLC, including exhibits.
2. Response letter from Doug Ahlstrom, Draper City Attorney, received January 9, 2008.

Statutes and Ordinances

1. Sections 10-9a-508 and -509 of the Utah Code.
2. Section 17-4-070 of the Draper City Code.

Background

In the fall of 2004, Ivory Development obtained approval to begin development of a residential subdivision which it called "Bellevue." Before construction began, Ivory entered into an Improvement Agreement with the City. Prior to final plat approval, Draper City requires developers to execute a bond agreement, to "insure completion of all improvements required to be installed in the subdivision." Draper City Code, § 17-4-070(a). The amount of the bond or security must be at least 110% of the estimated costs to install the improvements. *Id.* § 17-4-070(a)(5). Upon completion of the improvements, most of the bond would be released, with a portion maintained for an additional 18 months. During this period (the "warranty period"), the developer would guarantee the improvements against "any damage arising from any cause and

from any defect in design or construction." *Id.* § 17-4-070(a)(8). The developer would also be obligated to "promptly repair" any damage. *Id.*

The Improvement Agreement executed by Ivory and the City reflects the language and requirements of § 17-4-070. The escrow amount required for the Agreement was $266,037.25. Ivory provided satisfactory proof that an escrow account had been established that met the City's requirements. The Agreement provided that the City was authorized to access the funds in the account if Ivory was unable to complete the improvements.[1] The Agreement also provided that most of the obligation would be released upon completion of the improvements, with the final 10% remaining as a guarantee during the warranty period. The Agreement was signed in November of 2004.

Ivory began construction of the Bellevue Subdivision, and completed the improvements by the summer of 2005. On September 2, 2005, the City accepted the improvements, and the 18-month warranty period began on August 30 of that year. The City also released all but 10% of the escrow account, or about $80,800.00. The warranty period expired on February 28, 2007. During the warranty period, the City identified damage to the improvements, and Ivory conducted repairs. In February of 2007, shortly before the warranty period was to expire, the City presented Ivory with a "punchlist" of repairs to damage in the Bellevue Subdivision. According to Ivory, the City also required that at least some of the roadways be repaved or sealed before the City would release the escrow obligation. This requirement does not appear to be based on a need to repair damage to the roads.

Ivory states that some of the repairs requested by the City are excessive and burdensome. They point to minor scratches and pockmarks, most of which, in Ivory's view, have resulted from normal use, and are not indicative of inferior materials or craftsmanship. Ivory acknowledges that some damage is tied to the construction (for example, a collapse in a roadway caused by soil settling) and has taken steps to repair those problems. Ivory also states that at one point, the City Manager agreed that the City had "overreached" the scope of its authority, with respect to some of the repair requests. Although the City modified its requests somewhat, the latest repair punchlist, dated October 1, 2007, constituted six pages.

The City states that its requests are reasonable, that it has eliminated trivial repairs from its requests, and that the punchlists identify materially consequential damage dating from the warranty period during which Ivory agreed to provide repairs.

[1] The Agreement provided a 10-day notice to Ivory if the improvements were not completed as specified.

Analysis

I. The City's Requirement That Developers Provide Security to Ensure Completion of Public Improvements is a Valid Condition.

The Utah Code requires that all conditions on development must be expressed at the time a land use application is approved.

> A municipality may not impose on a holder of an issued land use permit a requirement that is not expressed:
>
> (i) in the land use permit or in documents on which the land use permit is based; or
>
> (ii) in [chapter 10-9a] or the municipality's ordinances.

UTAH CODE ANN. § 10-9a-509(e).[2] This section restricts a local government from imposing unannounced requirements or conditions, and it helps ensure certainty in applications and approvals.

Subdivision or development bonds are valid means to guarantee that public improvements will be built when new development is approved. Local governments require bonds (or some form of surety) to ensure that public improvements will be completed. The bond amount is determined by the estimated costs of unfinished public improvements. If a developer is unable to finish such improvements as streets or water systems, the bond furnishes money for completion. Draper properly required the Improvement Agreement as a condition on Ivory's subdivision, because the surety requirement is expressed in § 17-4-070 of the City's ordinances, and the specific requirements are included in the Improvement Agreement.

II. The City's Security Requirement is an Exaction.

The City's security requirement serves two purposes: (1) it guarantees a source of funds to finish public improvements if a builder is unable to complete them; and (2) it requires a warranty against damage or improper construction. The first purpose of the security requirement is not in dispute. Ivory completed the public improvements to the City's satisfaction, so there was no need to access the funds. Ivory's dispute stems from the second aspect of the requirement, and the City's demands for repairs which Ivory believes exceed the City's authority, and the purposes of the security requirement. As is explained more detail below, the security and warranty requirements must be evaluated as exactions.

[2] A parallel provision, applicable to counties, is found at § 17-27a-508 of the Utah Code.

A. The Security Requirement is an Exaction, and must Satisfy both Parts of Section 10-9a-508.

The City's requirement that a developer provide security to ensure completion of public improvements constitutes an exaction under Utah Law. "Exactions are conditions imposed by governmental entities on developers for the issuance of a building permit or subdivision plat approval." *B.A.M. Development, LLC v. Salt Lake County,* 2006 UT 2, ¶ 34, 128 P.3d 1161, 1169. Exactions include mandatory dedication of property, as well as fees. *Id.* Draper's security requirement is an exaction, because a bond or other surety is required before the City will grant approval of a final subdivision plat.

In 2005, the Utah Legislature enacted § 10-9a-508 of the Utah Code, which authorizes counties to impose exactions on new development, and also prescribes limits on that authority:

> A municipality may impose an exaction or exactions on development proposed in a land use application provided that:
>
> (a) an essential link exists between a legitimate governmental interest and each exaction; and
>
> (b) each exaction is roughly proportionate, both in nature and extent, to the impact of the proposed development.

UTAH CODE ANN. § 10-9a-508(1).[3] The Utah Supreme Court observed that the language of this statute was borrowed directly from the U.S. Supreme Court analyses in *Nollan v. California Coastal Comm'n,* 483 U.S. 825, 107 S.Ct. 3141 (1987) and *Dolan v. City of Tigard,* 512 U.S 374, 114 S.Ct. 2309 (1994). *See B.A.M.,* 2006 UT 2, ¶ 41, 128 P.2d at 1170. In those two cases, the Supreme Court promulgated rules for determining when an exaction is valid under the federal constitution's Takings Clause.[4] This has come to be known as the *Nollan/Dolan* "rough proportionality" test, and that two-part analysis is reflected in § 10-9a-508.

The *B.A.M.* decision indicates that the Utah Supreme Court—as well as Utah Legislature—agrees that any condition imposed on development approval is an "exaction," whether the local government requires dedication of a property right or not. *See B.A.M.,* 2006 UT 2, ¶ 46, 128 P.3d at 1171. It should be noted that in *Monterey v. Del Monte Dunes at Monterey, LTD*, the United States Supreme Court held that the "*Nollan/Dolan*" rough proportionality analysis did not extend exactions that did not require dedications of property. *Del Monte Dunes,* 526 U.S. 687, 703, 119 S.Ct. 1624, 1635 (1999). However, state courts have applied the rough proportionality test to "non-dedicatory" exactions, such as fees and payments for improvements.[5] Based on the

[3] There is a corresponding statute applicable to counties found at § 17-27a-507 of the Utah Code.

[4] *See* U.S. Const., amend V. The Supreme Court has interpreted the Takings Clause as limiting a government's ability to impose conditions on development. Furthermore, "[t]he Utah Constitution reinforces the protection of private property against uncompensated governmental takings . . .." *B.A.M.,* 2006 UT 2, ¶ 31, 128 P.3d at 1168. *See also* Utah Const. art. I, § 22.

[5] *See e.g., Town of Flower Mound v. Stafford Estates LP*, 135 S.W.3d 620 (Tex. 2004) (requirement that developer pay for improvements to streets not directly serving subdivision). The Texas Supreme Court cited to "non-dedicatory" cases from California, Illinois, and Ohio. *See also Town of Flower Mound v. Stafford Estates, LP*, 71 S.W.3d 18 (Ct. App. Tex. 2002)(lower court decision upheld by supreme court).

language in *B.A.M.*, as well as § 10-9a-508, it appears that the rough proportionality test applies to all conditions imposed on new development, including Draper's security requirement. Thus, in order to be valid, the City's security requirement must meet both parts of § 10-9a-508(1).

B. The City's Security Requirement Satisfies Section 10-9a-508(1)(a), Because There is a Link Between the Requirement and a Legitimate Governmental Interest.

The City has a legitimate interest in seeing that public improvements are completed properly. A requirement that a developer provide a source of funding for completion of improvements supports that objective, and is within the power of local governments. Although development or subdivision bonds are not specifically authorized in the current Utah Code, they are not prohibited either. In addition, a period during which the builder warrants construction is another reasonable means of guaranteeing that the public improvements will be properly constructed. There is thus an essential link between requiring a developer to provide some form of security for completion of improvements and the legitimate governmental objective of having the improvements completed, as well as the requirement that developers warrant or guarantee the improvements for a period of time.[6]

Moreover, there is also an essential link between the City's requirement that the developer repair damage and the legitimate governmental objective that public improvements be constructed properly and maintained in a good condition. The "essential link" prong of § 10-9a-508(1)(a) requires a connection, or "nexus," between the requirement imposed by the government and a legitimate governmental objective. An essential link is established if the requirement or exaction promotes a governmental objective. *See Nollan*, 483 U.S. at 837.[7] The City's requirement satisfies this prong, because there is an essential link between the requirement and the City's legitimate objective.

C. The City's Requirement that Damage be Repaired by the Developer must be Evaluated Under the "Rough Proportionality" Aspect of § 10-9a-508(1)(b).

In order to satisfy § 10-9a-508(1)(b), the City's requirement that a developer repair any and all damage must be shown to be roughly proportional to the impact of the development. Once an essential link between the government's requirement and a legitimate objective has been established, the analysis turns to whether the exaction is roughly proportionate, both in nature and extent, to the impact of the development. Thus, if the City's request for repair is not proportionate to the impact of the subdivision, it is not a valid exaction.[8] The analysis should take into account not only the cost of the proposed repair in relation to the impact of the subdivision, but also the cause of the damage, and whether the damage is attributable to a construction flaw or other activity unrelated to construction defects or acts by the developer.

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[6] Draper City has chosen a warranty period of 18 months. The length of the warranty period is not at issue in this Opinion.

[7] The "rough proportionality" prong of the test weighs the impact of project for which approval has been sought against the nature and extent of the proposed exaction. *See B.A.M.*, 2006 UT 2, ¶¶ 39-40, 128 P.3d at 1169-70.

[8] It appears that the surety requirement also satisfies the "rough proportionality" prong, because the amount of the surety is based on the estimated costs of the improvements. The focus of this Opinion concerns the City's requirement that the developer repair any damage to the improvements during the warranty period.

This analysis will guard against a government using its police power unfairly to leverage concessions and benefits to which it is not entitled.[9]

Although the language of the City's ordinance requires developers to repair "any damage arising from any cause and from any defect in design or construction," the ordinance does not excuse the City from analysis under the Takings Clause. The City cannot use its ordinance to justify exactions which are improper. "[T]he government can hardly argue that it is entitled to exact more from developers than is reasonably due [based on] the impact of [the] development." *Flower Mound*, 135 S.W.3d at 639. The U.S. Supreme Court agreed that proportionality "animates" the Takings Clause: "The Fifth Amendment's guarantee . . . was designed to bar the Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Del Monte Dunes*, 526 U.S. at 703, 119 S.Ct. at 1635 (*quoting Armstrong v. United States*, 364 U.S. 40, 49, 80 S.Ct. 1563, 1569 (1960)).[10]

Applying the rough proportionality analysis protects private developers from exactions that, in all fairness and justice, should be assumed by the public. It is fair and just that the public assume the responsibility for routine damage and normal wear on public improvements that have been accepted and approved by a government entity, rather than the developer who installed the improvements. It is also fair and just that the developer assume responsibility for damage attributable to its activity, or due to flaws in design, construction, or materials. It is unfair and unjust to force a builder to pay for damage caused by normal wear or by circumstances beyond the developer's control simply because it occurred within a certain time period, when the same damage would be borne by the public at large at any other time.

The analysis in this Opinion does not prohibit a local government from requiring a developer to guarantee construction work or to repair damage, provided the repair requests bear a reasonable relationship to the development activity.[11] It is the opinion of the Office of the Property Rights Ombudsman that a local government may require a builder or developer to warrant construction of public improvements; and that local governments may require repairs to damage to the improvements caused by the developer, or for damage attributable to flaws in the design, construction, or materials. These requests for repairs are bear a reasonable relationship to the impact of the development. On the other hand, a requirement that a single developer undertake repairs for damage caused by others, or for normal wear and tear, are improper exactions that exceed a local government's authority. Such requests are not roughly proportional to the impact of the development, and force developers to bear costs and responsibilities that, in all fairness and justice, ought to be borne by the public at large.

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[9] *See Flower Mound*, 135 S.W.3d at 639.

[10] As noted above, the Supreme Court does not apply the "Rough Proportionality" analysis to non-dedicatory exactions, but the Utah Code (and Utah caselaw) does. *Cf. Village of Norwood v. Baker*, 172 U.S. 269, 279, 19 S.Ct. 187, 191 (1898): "[T]he exaction from the owner of private property of the cost of a public improvement in substantial excess of the special benefits accruing to him is, to the extent of such excess, a taking under the guise of taxation of private property for public use without compensation."

[11] The *Dolan* court equated the "rough proportionality" test with the "reasonable relationship" test that had been applied by some states, including Utah. *See Dolan*, 512 U.S. at 391, 114 S.Ct. at 2319 (*citing Call v. West Jordan*, 606 P.2d 217 (Utah 1979)).

Along the same lines, requiring a new road overlay or slurry seal is also an exaction that must meet § 10-9a-508(1). There is an essential link between the overlay requirement and the City's legitimate interest in safe roadways. However, there has been no showing that the repaving or resealing the roadways is roughly proportional to the impact of the subdivision. There has been no showing that repaving is necessary due to a defect in construction, or is required because of damage caused by the developer. Unless there is such a showing, the City cannot require the overlay.

D. The Improvement Agreement is a Valid Contract, and the City is Entitled to Enforce its Provisions.

Notwithstanding the analysis of this Opinion, government entities may contract with private parties to modify the exchange of property rights or other benefits that would ordinarily be governed by an exaction or takings analysis. Such agreements are not prohibited. Draper City and Ivory entered the Improvement Agreement voluntarily and knowingly. Pursuant to that Agreement, Ivory is bound to repair "all damage arising from any cause" during the 18-month Warranty Period. An analysis of whether the Improvement Agreement is a valid contract, what items on the punchlist are the result of "damage," and to what extent the City may enforce its terms is beyond the scope of this Opinion, and is also outside the statutory mandate of the Office of the Property Rights Ombudsman.

Conclusion

The City may require that a developer provide security as a means of ensuring public improvements are installed as proposed. Section 10-9a-509(e) provides that a municipality may impose conditions on subdivisions, if those conditions are expressed in state law, local ordinances, or in documents upon which a permit is based. The bond requirement is a valid condition that is provided in the City's ordinances, and was also expressed in the Improvement Agreement signed by City and Ivory.

The City's security requirement is an exaction subject to the "rough proportionality" analysis of § 10-9a-508(1). It is an exaction because it is a condition imposed in order to obtain approval for a subdivision. The security requirement meets the "essential link" prong, because there is a link between the requirement and the City's legitimate interest that the public improvements be installed correctly. The warranty period and repair of damage requirements are also linked to the City's legitimate interests.

Requiring a developer to post security and warrant improvements for a period of time appears to meet the second prong of § 10-9a-508(1)(b), or the "rough proportionality" test. The amount of the security is based on the estimated costs of the public improvements, and the warranty period is a reasonable period to establish that the improvements have been constructed properly.

Requiring a developer to undertake repairs to public improvements must also meet the "rough proportionality" prong. The Takings Clauses of the Federal and Utah State Constitutions prohibit the government from forcing some to bear costs and burdens which ought to be borne by the

public as a whole. The City may require repairs for damage arising during the warranty period, but it must also establish that the repairs are roughly proportional, both in nature and extent, to the impact of the subdivision. Requests to repair damage not caused by Ivory, or attributable to a construction defect, are improper exactions, and exceed the City's authority.

Brent N. Bateman, Lead Attorney
Office of the Property Rights Ombudsman

NOTE:

This is an advisory opinion as defined in Utah Code Annotated, §13-43-205. It does not constitute legal advice, and is not to be construed as reflecting the opinions or policy of the State of Utah or the Department of Commerce. The opinions expressed are arrived at based on a summary review of the factual situation involved in this specific matter, and may or may not reflect the opinion that might be expressed in another matter where the facts and circumstances are different or where the relevant law may have changed.

While the author is an attorney and has prepared this opinion in light of his understanding of the relevant law, he does not represent anyone involved in this matter. Anyone with an interest in these issues who must protect that interest should seek the advice of his or her own legal counsel and not rely on this document as a definitive statement of how to protect or advance his interest.

An advisory opinion issued by the Office of the Property Rights Ombudsman is not binding on any party to a dispute involving land use law. If the same issue that is the subject of an advisory opinion is listed as a cause of action in litigation, and that cause of action is litigated on the same facts and circumstances and is resolved consistent with the advisory opinion, the substantially prevailing party on that cause of action may collect reasonable attorney fees and court costs pertaining to the development of that cause of action from the date of the delivery of the advisory opinion to the date of the court's resolution.

Evidence of a review by the Office of the Property Rights Ombudsman and the opinions, writings, findings, and determinations of the Office of the Property Rights Ombudsman are not admissible as evidence in a judicial action, except in small claims court, a judicial review of arbitration, or in determining costs and legal fees as explained above.

MAILING CERTIFICATE

U.C.A. §13-43-206(10)(b) requires delivery of the attached advisory opinion to the government entity involved in this matter in a manner that complies with U.C.A. §63-30d-401 (Notices Filed Under the Governmental Immunity Act).

These provisions of state code require that the advisory opinion be delivered to the agent designated by the governmental entity to receive notices on behalf of the governmental entity in the Governmental Immunity Act database maintained by the Utah State Department of Commerce, Division of Corporations and Commercial Code, and to the address shown is as designated in that database.

The person and address designated in the Governmental Immunity Act database is as follows:

Kathy Montoya, City Recorder
Draper City
1020 E. Pioneer Road
Draper, UT 84020

On this _____ Day of February, 2008, I caused the attached Advisory Opinion to be delivered to the governmental office by delivering the same to the United States Postal Service, postage prepaid, certified mail, return receipt requested, and addressed to the person shown above.

_____
Office of the Property Rights Ombudsman