SUBDIVISION IMPROVEMENT REQUIREMENTS AND GUARANTEES: A PRIMER

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I. INTRODUCTION

In the United States, subdivision control laws have become the preeminent method by which local governments regulate residential development.[1] These laws will continue in importance as a result of

1. The residential development process consists of three phases: development, construction, and occupancy. *See* S. SEIDEL, HOUSING COSTS & GOVERNMENT REGULATIONS 318 (1978). Subdivision controls are one of many types of regulations that control residential development. Subdivision controls, environmental regulations, and

population growth and migration patterns.[2] Perhaps the most significant aspect of subdivision control laws is the requirement that the land developer take responsibility for constructing and installing, at his own expense, a great array of subdivision improvements, including streets, drainage facilities, sewers, water systems, landscaping, and many others. Subdivision improvement requirements and guarantees are an integral part of the subdivision process, affecting the quality of residential development, the cost of housing, the structure of the development industry, and the fiscal welfare of the community. Subdivision improvement requirements are enforced by prohibiting the transfer of property within a subdivision until the local government approves the subdivision. Approval is conditioned on the developer's completion of the requisite improvements. Recognizing that many developments will

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growth controls affect the development phase, *id.*, with subdivision controls being directed at regulating undeveloped land by imposing site-specific regulations that can control the pattern of development. *See* D. HAGMAN, URBAN PLANNING AND LAND DEVELOPMENT CONTROL LAW 135 (1975). Although subdivision controls are related to zoning, they differ in that subdivision controls regulate the manner in which land is used rather than defining the uses themselves. *See id.*; D. MANDELKER, LAND USE LAW § 9.1 (1982). In many urban areas, subdivision control laws have become more important than zoning laws in regulating the quality of development in the community. *See* R. FREILICH & P. LEVI, MODEL SUBDIVISION REGULATIONS 13 (1975). Although subdivision controls are responsible for setting the pattern for community development, some commentators have suggested that little litigation concerning the controls occurred until recent times. *See, e.g.*, 5 N. WILLIAMS, AMERICAN PLANNING LAW §§ 156.01, 156.086 (1983) (noting in the 1975 edition that little litigation existed, but reporting in the 1983 supplement that litigation had increased rapidly in volume); R. YEARWOOD, LAND SUBDIVISION REGULATION 123 (1971). Part IV of this Article, however, demonstrates that subdivision controls have generated much litigation since their very inception.

2. *See* Alonso, *Metropolis Without Growth*, PUB. INTEREST No. 53, at 68 (1978). Although the rate of population growth has decreased, absolute population continues to increase. *Id.* at 73. More importantly, changes in family structure have increased the number of households and the consequent demand for housing. *Id.* at 83. Migration patterns also have been important in promoting residential development. Metropolitan areas have decentralized, increasing the population growth in suburban and rural areas. *Id.* at 73-77. Additionally, at a national level, population increases are most pronounced in the Sun Belt. *Id.* at 83. Many of the states experiencing the greatest population increases from 1970 to 1980 were in the western United States. For example, Colorado increased 30.7%, Wyoming increased 41.6%, Arizona 53.1%, and Nevada 83.5%. *See* R. ELLICKSON & A. TARLOCK, LAND-USE CONTROLS figure 1-2, at 8 (1981). All of these factors have a part in the projected rate of housing starts for the 1980s. It is estimated that housing starts will range from 1.5 to 1.7 million annually during the 1980s, more than in any prior decade. *See* J. WEIPER, L. YAP & M. JONES, METROPOLITAN HOUSING NEEDS FOR THE 1980S 4 (1982). Housing starts in metropolitan areas will be even greater, ranging from 2.4 to 2.7 million. *Id.* at 5.

founder if developers cannot sell lots within the subdivision until all improvements are completed, local governments accept bonds or other security guaranteeing the completion of subdivision improvements after the developer has been authorized to dispose of property in the subdivision.

This Article examines the subdivision improvement process in general and subdivision improvement requirements and guarantees in particular. Part II reviews the history of subdivision controls and the parties, interests, and themes involved in the subdivision control process. After this overview, Part III details the subdivision development process from the private and public sectors with particular emphasis on subdivision improvement requirements. Part IV surveys the case law regarding subdivision improvements. Finally, Part V evaluates the various methods for securing the completion of subdivision improvements and offers suggestions for reform.

II. AN OVERVIEW OF SUBDIVISION CONTROL IN THE UNITED STATES

A. *A Brief History of Subdivision Control Laws*

The subdivision of land for residential development is an inevitable by-product of modern industrial societies.[3] In the United States, the unabated pressures to subdivide land have led to the ubiquitous adoption of subdivision control legislation by state and local governments.[4] State and local governments adopted substantive subdivision control laws in response to the harmful consequences of the premature subdivi-

3. *See generally* P. CORNICK, PREMATURE SUBDIVISION AND ITS CONSEQUENCES 1-23 (1938). There is a natural relationship between industrial development and urban development. The division of labor, by which a number of individuals contribute to manufacture a single product, inevitably leads to population concentrations. Land must be subdivided for residential development. *See* M. CLAWSON, SUBURBAN LAND CONVERSION IN THE UNITED STATES 39-40 (1971). Conversely, with the advent of improved transportation, populations began to spread out within urban areas, resulting in the rapid subdivision of land on the urban fringe. *See* Alonso, *supra* note 2, at 76. The availability of federal home loan insurance and federal tax benefits also have increased the demand for housing and the subdivision of land. *See* M. CLAWSON, *supra*, at 41-46.

4. *See* R. HARRIS, CONSTRUCTION AND DEVELOPMENT FINANCING, at 2-12 (1982); D. MANDELKER, *supra* note 1, § 9.2. Seidel suggests that more stringent subdivision controls exist in the Northeast than in the South or the West. S. SEIDEL, *supra* note 1, at 25. The reactions of persons in the residential development industry, however, argue otherwise. *See id.* at 28-29 (46.6% of persons in the West reported that government regulations were the number one business problem that they faced).

sion of land that occurred in the late 1800s and early 1900s.[5] That period in American history witnessed a boom in land speculation that led to the division of large tracts of agricultural and forest lands into small residential parcels.[6] While some persons became rich as a result of this land boom, many others found themselves living in partially completed developments that lacked basic essential services. Still others held small tracts of land that were not needed for residential development and were not useful for any other type of development. Large areas of subdivided land were held in multiple ownership and remained vacant, generating little or no tax revenue, and eventually landowners forfeited these parcels to the government.[7]

Local governments were called on to provide the basic services required by some developments and incurred large debts as they issued revenue bonds to finance public improvements.[8] Because much land was vacant or had been forfeited for nonpayment of taxes, local governments shifted the tax burden to owners of developed lands.[9] Eventually, under the dual burden of an increased demand for public improvements and a diminishing tax base, many local governments defaulted on their bonds and contributed, at least in a small way, to the depression of the 1930s.[10]

State governments enacted subdivision control laws prior to the most serious problems created by the premature subdivision of land.[11] For the most part, however, the laws were designed only to aid in the recor-

5. *See* 4 R. ANDERSON, AMERICAN LAW OF ZONING § 23.01 (2d ed. 1983); D. MANDELKER, *supra* note 1, § 9.2.

6. *See* P. CORNICK, *supra* note 3, at 1-23. The amount of land that developers subdivided was out of proportion to the amount that was needed for residential growth as the lure of quick profits provided an incentive to land speculators attempting to get rich quickly. *Id.* at 2-3.

7. *See generally* P. CORNICK, *supra* note 3, at 120-56. "Premature subdivision" is a generic term encompassing a variety of problems: low-grade subdivision, excessive subdivision, partial or incomplete subdivision, and scattered subdivision. *See* R. YEARWOOD, *supra* note 1, at 66-72. Land that developers partially subdivide ends up in multiple ownership and may never be completed, resulting in "leapfrogging" as subsequent development goes beyond the boundaries of the partially subdivided areas. *See* D. HAGMAN, *supra* note 1, § 134. Leapfrogging also occurs when developers "jump" over areas subject to restrictive regulations and develop land in unincorporated areas that local governments often control less stringently. *See* S. SEIDEL, *supra* note 1, at 123.

8. P. CORNICK, *supra* note 3, at 156.

9. *Id.* at 120-56.

10. *See id. See generally* 2 THE PLATTED LAND PRESS: A JOURNAL OF ANTIQUATED SUBDIVISION STUDIES (Jan. 1985).

11. Massachusetts and New York passed subdivision control laws in the early

dation of land transfers and to facilitate the layout of city streets.[12] It was not until the late 1920s with the promulgation of the Standard City Planning Enabling Act that local governments began to use subdivision control laws as an important public policy tool.[13] State enabling statutes permitted local governments to enact ordinances that forced developers to bear the cost of constructing and installing many subdivision improvements. In some instances, local governments required the developer to complete all improvements before he could sell any land in the subdivision.[14] In other instances, however, municipalities permitted the developer to post a bond to secure the completion of subdivision improvements some time after the authorization was given to transfer land within the subdivision.[15] This method permitted an undercapitalized developer to receive some return on his investment before being required to incur the additional expense of completing subdivision improvements. At the same time, local governments hoped to avoid the financial burden that the subdivision of land had placed on them previously.

The period following World War II witnessed a shift in emphasis in subdivision control laws. Local governments began to adopt subdivision regulations to design communities by providing open space and recreational areas within developments.[16] Governments also became bolder in placing the burden of providing government services on the developer. Governments enacted laws requiring developers to dedicate land to the city for parks and school sites,[17] and required developers to

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1800s, *see id.* at 3, while Michigan and Wisconsin passed these laws in the 1830s. *See* R. YEARWOOD, *supra* note 1, at 86.

12. *See* D. MANDELKER, *supra* note 1, § 9.2; B. ROGAL, SUBDIVISION IMPROVEMENT GUARANTEES 1 (Planning Advisory Service Report No. 298 (1974)).

13. *See* R. FREILICH & P. LEVI, *supra* note 1, at 2; D. MANDELKER, *supra* note 1, §§ 9.2, 9.3.

14. *See* R. YEARWOOD, *supra* note 1, at 120.

15. *Id.* at 120-21.

16. *See* R. FREILICH & P. LEVI, *supra* note 1, at 3-4.

17. *See* D. MANDELKER, *supra* note 1, §§ 9.11, 9.13; 2 P. ROHAN, ZONING AND LAND USE CONTROLS § 9.01[1] (1983). *See generally* Ferguson & Rasnic, *Judicial Limitations on Mandatory Subdivision Dedications*, 13 REAL EST. L.J. 250 (1984). Note, *Subdivision Exactions: A Review of Judicial Standards*, 25 WASH. U.J. URB. & CONTEMP. L. 269, 272-79 (1983). Local governments can use a variety of methods to shift the cost of public improvements to the developer. Local governments may require the developer: to reserve land for the benefit of residents in the development; to dedicate the land to the local government, in which case the government takes title to the land; to pay fees to the government for the privilege of connecting to government services or in lieu of dedication; and to construct and install improvements, such as roads, sewers,

pay fees to offset the demands that residential development placed on the city infrastructure.[18] Since the 1970s, subdivision controls have served yet another purpose—limiting growth and its adverse environmental consequences.[19] These controls can mitigate the excessive demands placed on a local government's limited capital facilities while also minimizing environmental degradation.[20] Local governments, however, can use growth controls to exclude moderate and low income families from living in their communities.[21]

At all times since promulgation of the Standard City Planning Enabling Act, two principal concerns have motivated local governments: the desire to assure quality development and the need to shift some portion of the burden of providing public services to the developer.[22] Recent studies reveal the extent to which local governments have adopted subdivision improvement requirements and the great array of requirements that they impose on the developer.[23] Studies also suggest that subdivision control laws affect the location of development and the cost of housing.[24] Despite dozens of challenges to subdivision control laws, however, local governments have demonstrated no inclination to reduce the burdens imposed on developers.[25]

B. *Subdivision Control Laws: An Overview of Players, Interests, and Themes*

1. Players and Interests

The subdivision of land for residential use is a process that requires the successful interaction of the private and public sectors of the economy. On the private side, land owners, developers, lenders, sureties,

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and water systems that the developer then dedicates to the local government. *See* Comment, *Allocating the Burden of Increased Community Costs Caused By New Developments*, 1967 U. ILL. L.F. 318, 318.

18. *See* 4 R. ANDERSON, *supra* note 5, § 23.40 (discussing fees for parks and recreation); Note, *supra* note 17, at 270-71.

19. *See* R. FREILICH & P. LEVI, *supra* note 1, at 5-6.

20. *See* S. SEIDEL, *supra* note 1, at 18.

21. *See* 2 P. ROHAN, *supra* note 17, § 9.01[2].

22. S. SEIDEL, *supra* note 1, at 121.

23. *See* D. HAGMAN, *supra* note 1, § 138.

24. *See* Dowall, *Reducing the Cost Effects of Local Land Use Controls*, 47 J. AM. P. ASS'N 145, 146-47 (1981); Friedan, *Allocating the Public Service Costs of New Housing*, 39 URB. LAND 12, 12 (1980) (estimating that required improvements contribute 15% to the cost of a single-family home).

25. *See* R. YEARWOOD, *supra* note 1, at 120.

construction firms, laborers and materialmen, and individual homebuyers are involved. The public side involves technical planning staffs, planning commissioners, government engineers and building inspectors, local legislators, and a variety of state and local agencies that review development plans. Neighbors of the proposed development also are enlisted in support of either antidevelopment or prodevelopment forces.

Subdivision control laws implicate a variety of interests, not all of which are compatible. The development industry primarily is interested in reducing the cost of development and the delays that frequent administrative review.[26] In contrast, the government is concerned with assuring quality development and in shifting the cost of public improvements to the developer.[27] Homebuyers are caught in a conflict between the desire to live in a development with an adequate infrastructure and the need to minimize the expense of buying a home. Neighbors are interested in ensuring that the development does not diminish the value of their homes or create hazards that will jeopardize their health and safety. Somehow, subdivision control laws must satisfy these various and conflicting interests.

2. Themes

The importance of subdivision regulations in general, and subdivision improvement requirements in particular, cannot be overemphasized. That importance is reflected in several themes that recur throughout this Article. Subdivision regulations now are the primary tool by which local governments can affect the quality of residential development.[28] Government-imposed improvements according to government standards and specifications are calculated to assure homebuyers an adequate infrastructure for their development. This concern for quality, however, implicates the first major theme—cost.[29] Imposing subdivision improvements on the developer causes him to at-

26. *See* Dowall, *supra* note 24, at 146-47.

27. *See* S. SEIDEL, *supra* note 1, at 121; Note, *supra* note 17, at 270-71.

28. *See* R. YEARWOOD, *supra* note 1, at 37-38. Subdivision control laws improve the quality of development in a number of ways. First, controls increase the likelihood that developments will be completed and that an adequate infrastructure will be available. Second, low-grade subdivisions are avoided by imposing a community standard on improvements. Third, predictability is increased for the developer who learns what his up-front costs will be and who can then better plan the subdivision. *See* S. SEIDEL, *supra* note 1, at 124-25.

29. *See* S. SEIDEL, *supra* note 1, at 39. "Subdivision controls were overwhelmingly

tempt to recoup the costs of improvements by including them in the selling price of lots and homes.[30] Developers assert that many improvements are unnecessarily expensive with the result that many Americans might be priced out of the home-buying market.[31] On the other hand, local governments reason that it is necessary to shift the cost of improvements to the developer because the government is unable to finance the capital improvements required by residential subdivisions that do not "pay for themselves" with the tax revenues that they generate.[32] Thus, although a local government might prefer resi-

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cited [by the study group] as the type of regulation most responsible for unnecessarily increasing the costs of housing." *Id.*

30. *See* Friedan, *supra* note 24, at 12.

31. It cannot be doubted that developers will attempt to recoup the costs of improvements by passing these costs along to lot or homebuyers. *See* L. SAGALYN & G. STERNLIEB, ZONING AND HOUSING COSTS 38 (1972). A study of new houses built in northern Virginia demonstrated that lot development costs increased 74.1% between 1969 and 1975. S. SEIDEL, *supra* note 1, at 120. In a Chapel Hill, North Carolina study, the per unit cost of land development on a condominium project was in excess of $12,000. *Id.* at 58. A Denver, Colorado developer reported that the cost of a finished lot in a recent development was $23,000. *See* Ditmer, *Writer: Pioneer in Open Space Planning*, Denver Post, Feb. 19, 1984, at I1. The alleged results of these costs are a decrease both in housing starts and in the affordability of housing. *See* S. SEIDEL, *supra* note 1, at 3. Although recent data suggests that more Americans are able to afford housing, this is only because more houses in lower price ranges are being built as the overall quality of houses decreases. *See* Austin, *Falling Interest, Rising Earnings Help Make Home-Buying Easier*, Denver Post, Feb. 19, 1984, at I33. In addition, even though more persons currently are able to purchase homes, a significant percentage of "younger and poorer households" are unable to do so. *Id.*

Beyond the direct costs created by subdivision improvement requirements, delays that result from the subdivision approval process also add to the developer's cost. It is estimated that each additional month of delay adds 1% to 2% to the selling price of a home. *See* S. SEIDEL, *supra* note 1, at 32. Delays affect overhead costs, increase interest payments, and subject the developer to inflationary pressures.

At least one commentator is unimpressed by the costs imposed by subdivision improvements. Freilich argues that these costs can be amortized over a lengthy period of time and thereby reduce the effect on the homebuyer. R. FREILICH & P. LEVI, *supra* note 1, at 105. The alternative is to have the government install the improvements and then assess the homebuyer over a much shorter period of time. The fact remains, however, that the kind of cost increases imposed by improvement requirements necessarily results in many persons being unable to qualify for a new home loan. All that has been said to this point assumes that the developer can pass the costs of improvements along to the homebuyer; if he cannot, the developer may be forced to absorb the costs by decreasing his profit margin. The margin for error in most developments is very slight, however, and if the developer is unable to recoup his costs, bankruptcy might follow. *See* M. CLAWSON, *supra* note 3, at 59.

32. *See* L. SAGALYN & G. STERNLIEB, *supra* note 31, at 14-15; McPherson, *An Underused Form of Land Use Control-Subdivision Improvement Bond Requirements*, 45

dential development, it cannot afford to extend basic services in the hope that tax revenues will reimburse the government; consequently, the cost of providing these services is shifted to the developer and, ultimately, the homebuyer. Subdivision improvement requirements, therefore, have developed into an important aspect of local fiscal planning.[33]

Closely linked to cost is a second important theme—the exclusionary effect of subdivision regulations. Although a local government legitimately can shift the cost of capital improvements to the developer, excessive improvement requirements can be a subterfuge by which the local government can exclude low income persons from the community.[34] Several courts have demonstrated a willingness to strike down

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PA. B. A. Q. 461, 477 (1974). The local government certainly would be unable to recoup its costs if after completing the public improvements, the development failed. *See* B. ROGAL, *supra* note 12, at 8-9.

33. The use of fiscal impact analysis in local zoning and planning decisions is a hotly debated issue. It is true that many local governments have been hard pressed to meet the demands for public services that residential development has created. The obvious solution was to require the developer to provide the public improvements. The developer, in turn, will pass the costs along to the homebuyers that created the demand. *See* 2 P. ROHAN, *supra* note 17, § 9.01[1]. On the other hand, local governments cannot be permitted to base their planning decisions solely on fiscal outcomes. Such a process will result in the exclusion of low income persons from all localities. *See* Delogu, *The Misuse of Land Use Control Powers Must End: Suggestions for Legislative and Judicial Responses*, 32 ME. L. REV. 29, 55 (1980).

34. *See* Cutler, *Legal and Illegal Methods for Controlling Community Growth on the Urban Fringe*, 1961 WIS. L. REV. 370, 387. Exclusionary zoning and planning is closely allied with fiscal zoning and planning. Exclusionary land use controls prevent "unwanted" households from setting up residence in the locality. *See* 2 P. ROHAN, *supra* note 17, § 2.01[1]. The cost of housing is the key factor in erecting barriers to low income and minority persons. *Id.* § 2.01[2]. Thus, local governments may impose excessive improvement requirements for the purpose of making housing too expensive for low income persons. While the requirements may be justifiable on a fiscal policy basis, they become unreasonable when their purpose is to exclude. *See* Surrick v. Zoning Hearing Bd. of Adjustment, 476 Pa. 182, 185, 382 A.2d 105, 108 (1977). The United States Supreme Court has refused to invalidate zoning ordinances that have the effect of excluding low income and minority persons when no motive or purpose to exclude was demonstrated. *See* Village of Arlington Heights v. Metropolitan Hous. Dev. Corp., 429 U.S. 252 (1977). The New Jersey Supreme Court, however, has taken the lead in establishing an obligation on the part of local governments to make low income housing opportunities available. In Southern Burlington County NAACP v. Township of Mount Laurel ("*Mount Laurel I*"), 67 N.J. 151, 180-81, 336 A.2d 713, 728, *appeal dismissed & cert. denied*, 423 U.S. 808 (1975), the court held that the plaintiffs had made out a prima facie case for the invalidity of local land use controls when they demonstrated no realistic possibility for a variety of housing that included moderate income housing. More recently, in Southern Burlington County NAACP v. Township of Mount Laurel ("*Mount Laurel II*"), 92 N.J. 158, 456 A.2d 390 (1983), the court established an affirmative obligation on local governments to make low income housing

local regulations that limit the availability of low- or moderate-priced housing in a community.[35]

A third theme is the need to recognize the impact of government regulations on industry organization. Subdivision regulations can have the effect of limiting entry into the development market by imposing financial responsibility and subdivision improvement requirements.[36] Only financially sound developers can compete in the market if governments force developers to install improvements prior to selling lots or homes, or post a corporate surety bond in lieu of completion. As market entry barriers are enacted, concentration in the market will increase with a concomitant increase in prices and a decrease in quality.[37]

The development industry is highly competitive at the present time. In 1978, for example, the nation's largest homebuilder accounted for

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available. Thus, it is possible to invalidate subdivision improvement requirements or guarantees if it can be shown that local governments enacted them for the purpose of excluding low income persons or that the requirements make low income housing impossible to construct and the requirements have an insufficient relationship to health and safety. It is interesting that one study found that upper income cities demanded the most from developers, and thereby increased the cost of housing. *See* Friedan, *supra* note 24, at 14.

35. *See, e.g., Mount Laurel II*, 92 N.J. 158, 456 A.2d 390 (1983); Surrick v. Zoning Hearing Bd. of Adjustment, 476 Pa. 182, 382 A.2d 105 (1977). *But see* Appeal of M.A. Kravitz Co., 501 Pa. 200, 460 A.2d 1075 (1983) (Pennsylvania Supreme Court upheld a partially exclusionary zoning ordinance under a deferential standard of review). For a thorough treatment of the exclusion issue, see R. BABCOCK & F. BOSSELMAN, EXCLUSIONARY ZONING: LAND USE REGULATION AND HOUSING IN THE 1970S (1973); Comment, *A New Deference Towards Exclusionary Zoning in Pennsylvania:* Appeal of M.A. Kravitz Co., 28 WASH. U.J. URB. & CONTEMP. L. 381 (1985).

Land use controls also affect housing costs indirectly when developers decide to build homes in areas with less stringent regulations. Seidel discovered that, in the West, over 76% of those questioned in his survey said that government regulations affected their decision on where to build. S. SEIDEL, *supra* note 1, at 36. Thus, by decreasing the stock of housing, a government indirectly can force up the cost of housing and cause the exclusion of low income persons.

One answer to the potential exclusionary effect of costly subdivision regulations is to permit flexible requirements based on land use, intensity, and location. *See* T. PATTERSON, LAND USE PLANNING: TECHNIQUES OF IMPLEMENTATION 105 (1979). The problem with this solution is that it poses the potential for creating second class neighborhoods with less than adequate infrastructures to serve low income residents. Rather than permit low-grade improvements for low-income housing projects, local governments should analyze their requirements to ensure that they do not add unnecessarily to the cost of housing. *See* S. SEIDEL, *supra* note 1, at 53 (estimating unnecessary costs at one residential development in New Jersey).

36. *See* B. ROGAL, *supra* note 12, at 6.

37. *See generally* L. SCHWARTZ & J. FLYNN, ANTITRUST AND REGULATORY ALTERNATIVES 71-97 (5th ed. 1977).

only "six-tenths of one percent of the national market."[38] Moreover, in that same year, the nation's top thirty-six builders produced only five percent of all delivered homes.[39] Although this competitive posture tends to drive prices down, a number of countervailing forces are at work: the activity of most developers is localized, the industry as a whole is fragmented, and most of the firms engaged in all parts of the industry are small.[40] As a result, developers lack most of the benefits associated with large scale operations and are highly sensitive to the impact of local regulations.

Additionally, local governments must recognize that subdivision regulations that they impose on a developer will have ripple effects throughout the development industry. The interests and conduct of landowners, lenders, and builders will be affected whenever increased costs are imposed on developers. Similarly, conditions that local governments impose on developers will affect homebuyers and their lenders.[41] Local governments should appreciate the systemic effects of their regulations before they increase the burdens on the land developer.

A final theme is the need for flexibility in subdivision regulations. Local governments should adapt subdivision regulations to each particular type of development. Not all developments, even residential developments, require the same improvements.[42] Similarly, local governments should make available several methods to secure completion of improvements to account for the needs of individual developers.[43] Such flexibility, however, must be accomplished within the limits of standards that can guide decision-makers. If standards are not available, the industry might "capture" those that are supposed to regulate it.[44]

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38. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 23 (citing HOUSING, June 1979, at 82-83).

39. *Id.*

40. PRESIDENT'S COMMITTEE ON URBAN HOUSING, A DECENT HOME 117 (1969).

41. *See* Melli, *Subdivision Control in Wisconsin*, 1953 WIS. L. REV. 389, 395-96.

42. *See* T. PATTERSON, *supra* note 35, at 105. For example, the size of a water main should be permitted to vary with the density of the development. Similarly, road surfaces should vary dependent on the amount of traffic in the subdivision.

43. *See* S. SEIDEL, *supra* note 1, at 135.

44. *See id.* at 308-09; R. FREILICH & P. LEVI, *supra* note 1, at 23. Standards are important for at least four reasons. First, standards define local authority, thereby minimizing the suggestion of an unconstitutional delegation of power. Second, they constrain local decision-making and limit the possibility for arbitrary and capricious action.

Ultimately, the goal of any subdivision control regime should be to guarantee quality development at the least possible cost with a proper allocation of responsibility between the public and private sectors. While that goal is simple to state, it is difficult to implement as a result of the many and varied parties and interests that are involved in the subdivision of land.

III. SUBDIVISION DEVELOPMENT

A. *The Private Sector*

The ultimate object of the development process is the production of homes.[45] The role played by the developer in this process may be stated in deceptively simple terms. The developer envisions a project, acquires land, secures financing, installs improvements, constructs homes,[46] and, hopefully, sells the finished product at a profit. In reality, however, the development process is not nearly as simple.

The housing industry is one of the most complex industries in the country.[47] It includes literally hundreds of types of specialty firms, all of which are fiercely competitive.[48] The nature of the product itself creates difficulties that add to the complexity of the process and ultimately result in higher costs to the consumer.

Third, standards limit the opportunity for local governments to "extort" large concessions from developers whose businesses are dependent on local approval. Finally, standards assist in preventing some developers from obtaining favors from the government because they are connected politically. *See* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 236-38, 244-47 (discussing political corruption and deal-making in land use decisions).

45. The development of commercial and industrial subdivisions may lead to some of the same problems that surround the residential subdivision process. Nevertheless, residential development is by far the largest use of urban and suburban land. M. CLAWSON, *supra* note 3, at 8; *See* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 17, table 1-1 (quoting Niedercorn & Hearle, *Recent Land Use Trends in Forty-Eight Large American Cities*, 40 LAND ECON. 105-06, table 1 (1964)). Additionally, it accounts for the overwhelming majority of the reported cases.

46. For a small number of firms, land development is limited to the acquisition and subdivision of raw land and the installation of improvements such as streets, sewers, and watermains. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 22; *see* S. SEIDEL, *supra* note 1, at 25 (quoting CENTER FOR URBAN POLICY RESEARCH, SURVEY OF THE HOME BUILDER INDUSTRY (1976)). Most firms, however, engage in both land development and home construction. *Id.*

47. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 113. *See infra* notes 81-100 and accompanying text.

48. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 113.

Certain distinctive features of housing require a production and delivery system unlike that of any other industry. First, housing is tied to the land.[49] This simple fact makes the development process highly susceptible to local regulation[50] and tends to perpetuate the localization of markets.[51] Second, housing has long-term durability.[52] Provided that a house is structurally sound, it can be repaired or remodeled, and it may last for generations. Thus, if market conditions prove unfavorable, a large number of potential new homebuyers may fall back on this readily available alternative to purchasing a new home.[53]

The sheer size of a home is another of its distinctive features.[54] Due mainly to high overhead, storage, and transportation costs, it generally is thought that on-site assembly is the least expensive method of production for most types of housing.[55] Because the assembly is completed outdoors at the various jobsites, however, the homebuilder is prone to the vagaries of the local labor market and the weather.[56]

The high cost of a house is perhaps its most distinctive characteristic. Indisputably, the family home constitutes the single largest expenditure that most families will make.[57] Since World War II, an increasing number of homebuyers have financed their home purchases; presently, more than ninety percent of all new homes are financed.[58] Thus, not only are the sales of new homes subject to the fluctuating mortgage market,[59] but also the lenders themselves can exert a major influence on the entire development process.[60]

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49. *Id.* at 114.

50. Local governments traditionally have been responsible for land use and development regulation, *id.*, and local regulation continues to play the dominant role in the subdivision approval process. *See* S. SEIDEL, *supra* note 1, at 19-20.

51. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 114.

52. *Id.*

53. *See id.* at 114-15; *see also* M. CLAWSON, *supra* note 3, at 80 (suggesting that most new homebuyers purchase by choice rather than out of necessity).

54. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 114.

55. *Id.* at 116. Prefabricated or sectionalized homes have been most economically competitive in areas where modern onsite assembly-line techniques have not been available. In contrast to prefabricated homes, the industry has very successfully employed prefabricated components such as roof trusses, prehung doors, and sectionalized wall systems.

56. *Id.*

57. *Id.*

58. *See* M. CLAWSON, *supra* note 3, at 99.

59. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 116.

60. M. CLAWSON, *supra* note 3, at 71-72.

Against the backdrop of the housing industry's distinctive product, the development process may be surveyed best from the points of view of the major actors in this process. These actors encompass a wide array of individuals and firms ranging from the original landowner to the ultimate homebuyer. Although their interests and objectives differ significantly, they all share three common characteristics: they cooperate with one another; they compete with one another; and they have an impact on the decision-making process.

1. The Landowner and Land Dealer

The first actor in the development process is the landowner. Originally, the landowner probably was a farmer or rancher. More commonly, however, the developer purchases land from an interim landowner—the "notorious" land speculator.[61] The speculators, or land "dealers," are a relatively small group of individuals and firms that hope to profit as the land shifts from rural to urban use.[62] On the way to the realization of that profit, however, landowner-dealers can perform several important functions in the development process.

Landowner-dealers *may* function as market makers.[63] Assume, for example, that a developer desires to build in a particular area. It *may* be difficult to find a farmer or rancher that is willing to sell at the appropriate time. Even if a dealer can locate a willing seller, the available parcel may not be of the optimum size. Conversely, assume that a farmer desired to sell out to a developer at a handsome profit. He may be unable to locate a developer with the means and desire to purchase the land at that time. Thus, the dealer can perform a beneficial service to both parties by being prepared to buy or sell at any time. In short, it is the dealer that assumes the risk of holding the land.[64]

The dealer performs a second important function by assembling land into parcels of optimum, or at least desirable, size for development.[65] The dealer may perform this function either by acquiring small parcels directly from the several adjacent owners or by trading among them-

61. *Id.* at 62.

62. *Id.* at 103. Clawson has estimated that farmers realize about half of the total increase in the value of land with the other half being distributed among the various interim owners and dealers. *Id.* (citing A. SCHMID, CONVERTING LAND FROM RURAL TO URBAN USES (1968)).

63. *See* M. CLAWSON, *supra* note 3, at 62.

64. *Id.*

65. *Id.* at 62-63.

selves.[66] Considering the increase in the size of many subdivision developments in recent years, the assembly function has become more important.[67]

To be successful, the land dealer must possess knowledge, not only of what land local governments will rezone, but also of what land is ripe for rezoning. The dealer may gain this knowledge by studying growth trends, by familiarizing himself with the local zoning process as well as with individual board members, and by actively lobbying for zoning changes.[68] Where the land is unzoned or zoned for agricultural use, a zoning change is essential to a successful development. Thus, dealers often purchase raw land conditioned upon obtaining specific rezoning.[69] Accordingly, although the land dealer and developer are in direct competition for ultimate profits during the negotiation stage, they become "staunch allies in the subsequent dealings with . . . local officials" as soon as the contract has been signed.[70]

Perhaps the most important function that the land dealer may perform is that of financing the purchase of the land. Because developers typically are undercapitalized,[71] it is unlikely that developers can purchase the land with cash. Land dealers, therefore, offer a variety of financing methods to enable the development to proceed. Of the three basic forms of financing available to the developer, the purchase money mortgage is the most common.[72] The land dealer takes a small percentage of the total purchase price in cash and accepts the developer's note and mortgage for the balance. As the developer improves and sells lots, the land dealer releases these lots from the mortgage,[73] and receives a pro rata portion of the outstanding indebtedness from the sale proceeds.[74]

A similar result is obtained by use of the land contract of sale.

66. *Id.* at 102.

67. *Id.* at 63.

68. *Id.* at 102-03.

69. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 22.

70. *Id.*

71. M. CLAWSON, *supra* note 3, at 71.

72. M. MADISON & J. DWYER, THE LAW OF REAL ESTATE FINANCING ¶ 9.01[1] (1981); *cf.* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 25 (describing purchase money mortgages) (quoting S. MAISEL, FINANCING REAL ESTATE 315-18 (1965)).

73. For a discussion of some of the problems associated with the release of lots, see *infra* notes 294-95 and accompanying text.

74. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 25 (quoting S. MAISEL, FINANCING REAL ESTATE 315-18 (1965)).

Under this method of financing, the developer contracts to purchase the land, but the seller retains title to the entire parcel. As lots are developed and sold, the seller transfers title directly to the lot- or home-buyer and receives payment from the proceeds.[75]

A third method, while not strictly a financing technique, nevertheless has a similar effect in that it allows the developer to tie up a large parcel of land with a minimum of capital. Basically, the developer buys one section of the tract, either for cash or by some form of seller financing, and also obtains options to purchase other sections as needed.[76] Although this technique may enable a developer to control vast parcels of land, recent escalations in land values have increased option prices beyond the reach of many developers.[77]

With respect to all types of seller financing, two general observations may be made. First, the developer almost certainly will need additional financing in order to improve the lots and construct houses. Because development financing is extremely risky, the lender will require that the developer secure the loan with the land.[78] Accordingly, the seller must subordinate the mortgage on the land to the later development loan.[79] The second observation is that regardless of the method of land financing used, the developer will increase the price of the land as he passes on to homebuyers the cost of financing his purchase.[80]

2. The Developer

The developer can be distinguished from the builder. Strictly speaking, the developer acquires raw land, subdivides it, and installs improvements such as streets, curbs, sidewalks, sewers, and water

75. *Id.* at 24-25.

76. *Id.* at 24.

77. *Id.*

78. *See* M. MADISON & J. DWYER, *supra* note 72, ¶ 9.01[1][d]. The land seller will give up his priority only if the developer assures him that he actually will use the proceeds from the subsequent development loan to improve the land. Thus, while the seller's lien will be in a junior position, the infusion of funds from the development loan should result in an increase in the value of the property sufficient to offset the amount of the new first lien. *Id.*

79. *Id.*

80. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 25 (quoting S. MAISEL, FINANCING REAL ESTATE 315-18 (1965)). The additional cost factor may be mitigated somewhat by Internal Revenue Code § 453, which allows installment sellers to defer recognition of gain for federal income tax purposes until the tax year in which the proceeds actually are received. I.R.C. § 453A (1982).

mains.[81] The builder, on the other hand, ordinarily acquires already subdivided and improved lots and constructs houses on them.[82] This distinction has become less important in recent years and, at present, most developers perform both functions.[83]

Developers come in many shapes and sizes, but they all have one overriding common interest: they are engaged in the business to make a profit. In order to maximize his profit potential, the successful developer must acquire the best land and the most credit at the lowest cost, minimize his tax liabilities, take advantage of the most favorable government programs, design and construct an attractive product, and market that product quickly and efficiently. A more detailed discussion of each aspect of the developer's function suggests some of the reasons for subdivision failures, the necessity for adequate security to assure the completion of required subdivision improvements, and the impact that subdivision requirements have on the development process.

The developer's first goal is to acquire a suitable parcel of land. Although the developer often will desire a tract of a certain size and in a particular area, the acquisition of land usually is based on an ad hoc decision that turns primarily on the price at which he may acquire the available land.[84] Because most land ripe for development is held by relatively few land dealers,[85] the successful developer must be able to perform a two-tier negotiating and decision-making function. First, the objective data—the demand for housing, cost of credit, and availability of mortgage financing—must be considered. Second, the developer must consider the goals of the particular land dealer and the impact that the sale will have on the price and availability of land that he may need to acquire in the future.[86]

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81. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 22.

82. S. SEIDEL, *supra* note 1, at 24.

83. *See* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 22. In a recent survey, 61% of all responding firms indicated that they were active in both land development and building. S. SEIDEL, *supra* note 1, at 24-25 (citing CENTER FOR URBAN POLICY RESEARCH, SURVEY OF THE HOME BUILDER INDUSTRY (1976)). Although various terms, such as "operative builder" and "merchant builder," are used to describe firms engaged in both the development and building phases of the process, *see* M. CLAWSON, *supra* note 3, at 86-87, this Article uses the terms "developer" and "builder" interchangeably.

84. *See* M. CLAWSON, *supra* note 3, at 60.

85. *See supra* notes 61-62 and accompanying text.

86. Clawson has suggested that the relationship between developers and land dealers may be characterized more accurately as "gamesmanship" than as true competition. M. CLAWSON, *supra* note 3, at 79.

Assuming that the developer can acquire a suitable parcel of land and obtain financing, he then must arrange for a development loan.[87] For a variety of reasons, developers have tended to be substantially under capitalized.[88] Low capitalization gives the developer a great deal of leverage, which may result in high profits if the project is successful. Leverage, however, may work in the opposite direction as well; consequently, an apparently solid developer can be wiped out almost overnight because he has no ready cash with which to meet unforeseen expenses.[89]

The high risk of loss for the developer translates directly into a high risk for the development lender.[90] Thus, the developer faces a two-fold problem in obtaining financing: first, credit may not be available at any price for inexperienced developers or for those whose track record is weak; and second, regardless of its availability, the cost of credit will be high.[91]

In addition to the land acquisition loan and the development loan, the developer that also intends to build must secure a construction loan and arrange for suitable take-out financing.[92] Thus, the most successful developers often are those that can arrange the most attractive financing.[93]

The third basic function of the developer is designing and building.[94]

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87. The development loan constitutes the funds necessary to install off-site improvements and is distinguishable from the construction loan, which is used to finance the actual construction of the houses. Often, however, the installation of off-site improvements and the construction of houses are carried on concurrently and are financed together. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 25 (quoting S. MAISEL, FINANCING REAL ESTATE 318 (1965)).

88. M. CLAWSON, *supra* note 3, at 71. Clawson has suggested that the lack of size of development firms, the use of capital for quick expansion, and the relative lack of outside equity capital are reasons for low capitalization rates in the development industry. *Id.*

89. *See id.*

90. M. MADISON & J. DWYER, *supra* note 72, ¶ 9.01. In addition to the risk of loss caused by an unsuccessful development, the lender also may risk delays in receiving his payments because of the developer's lack of a steady income stream. *Id.*

91. Development and construction loans at 20% interest or more are not uncommon. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 24 (quoting S. MAISEL, FINANCING REAL ESTATE 316 (1965)).

92. The take-out loan, the ultimate owner's permanent financing, is commonly arranged simultaneously with or before the construction loan is obtained.

93. *See* M. CLAWSON, *supra* note 3, at 72.

94. *See supra* notes 81-83 and accompanying text.

While the development process begins with the developer's vision of the completed project, the details necessarily will be altered by the topography and value of the land,[95] the availability and cost of credit, labor and materials, and the perceived nature and strength of the demand for the finished product. It is also at this stage that the local government unit has its greatest impact.[96]

Recognizing that he is subject to external forces beyond his control, the developer, nevertheless, has room to exercise his creativity and innovation in the design and construction phase.[97] Streets may be laid out in a grid or with curves and cul-de-sacs; the houses may be separate, attached, or clustered; the architectural style may be varied or standardized;[98] interior appointments may range from the bare bones to the luxurious; and common amenities may include swimming pools, tennis courts, and golf courses.

The success with which he has carried out the design and construction phase has a direct relationship to the developer's final function, that of the merchant. This is perhaps the most stressful phase of the entire development process. The developer has acquired the land, arranged financing and spent funds, purchased or ordered materials, hired labor, completed off-site improvements, or nearly so, and perhaps has begun construction on a number of houses.[99] Moreover, because

95. M. CLAWSON, *supra* note 3, at 60.

96. A partial list of the various types of regulations imposed at the local level includes: Bonding requirements, building codes, energy codes, engineering inspection, environmental impact reviews, mechanical codes, plat review, sewer connection approval and fees, landscaping requirements and tree removal permits, site plan review, soil testing, utility connection fees, water connection approval and fees, and zoning. S. SEIDEL, *supra* note 1, at 20. Thirty-eight percent of responding builders and developers cited the cumulative burden of these regulations as the "most significant problem in doing business." *Id.* at 27 (citing M. SUMICHRAST & S. FRANKEL, PROFILE OF THE BUILDER AND HIS INDUSTRY 95 (1970)).

97. *See* M. CLAWSON, *supra* note 3, at 74-75. One has only to compare the drabness of the tract housing of the immediate post-war era with the wide variety of housing currently available to realize the amount of innovation that actually has occurred.

98. Developers easily can achieve a remarkable variation in the exterior appearance of houses in a modern subdivision. In a typical medium-size or large subdivision, the developer may utilize, for example, five standard floor plans and offer a choice of three exterior finished materials. Moreover, the developer may reverse each plan. Thus, a tour through the completed subdivision may disclose as many as thirty apparently different homes.

99. In the larger subdivisions, the developer will have constructed a sales office and from one to six model homes. These, of course, usually are fully completed, landscaped, decorated, and furnished at considerable expense.

the development process is lengthy, the market conditions may have changed radically. At this point, however, there is little that the developer can do except wait and hope that the purchasers will buy.[100]

In short, the development process is one in which the land seller, the developer, and the lender may have invested millions of dollars before they have received a single dollar in return. Nevertheless, the developer must service the loans and pay for labor, materials, and overhead. Thus, if the houses sell quickly, the developer stands to earn a profit commensurate with the risk. If the houses fail to sell, default virtually is certain.

3. Lenders

The institutions that finance the various phases of the development process include insurance companies, commercial banks, savings and loan associations, and mortgage companies.[101] On the whole, they tend to be large—much larger, certainly than the clientele that they serve.[102] Typically, institutional lenders make loans at every stage of the process, for such purposes as land acquisition, subdivision improvements, construction, security, and the purchase of the finished product.[103]

Because of the relatively large size of the institutional lenders and the pervasiveness of the need for financing, lenders have a major impact on the development decision-making process.[104] This impact is enhanced by the fact that the lender occupies a position on the periphery of the industry.[105] While land development may be the developer's sole business, development and construction loans often will account

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100. Developers build a large number of subdivision homes speculatively—that is, they are built completely, or nearly so, prior to the time of sale. These homes represent a tremendous amount of borrowed capital for which there is little or no hope of repayment prior to the sale. *See* R. HARRIS, *supra* note 4, at 4-40.

101. *Id.* at 1-4 to 1-5. Some of the largest developers achieve significant financing cost savings by arranging lines of unsecured bank credit or by issuing various corporate debt instruments. R. ELLICKSON & A. TARLOCK, *supra* note 2, at 26.

102. *See* M. CLAWSON, *supra* note 3, at 100.

103. R. HARRIS, *supra* note 4, at 3-4. Some lenders prefer to participate in only one phase of the development process, while others prefer to participate in the entire project. For a discussion of the advantages and disadvantages of "total project financing," see *id.* at 4-34 to 4-35.

104. M. CLAWSON, *supra* note 3, at 71 (citing C. HAAR, FEDERAL CREDIT AND PRIVATE HOUSING (1960); S. MAISEL, FINANCING REAL ESTATE (1965)).

105. PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 117.

for only a small portion of the lender's business. Thus, the lender is in a uniquely powerful position to control the development process.[106]

The lender's overriding concern is for the security of the loan. Because of low capitalization at every stage of the process,[107] developers are highly leveraged; consequently the risk of developer failure is high.[108] In an attempt to minimize its risk, the lender may exert its control and influence in a number of ways. First, the lender may withdraw funds from the development process. Because the lender has investment options unrelated to the development industry, it is not compelled to lend if the risks seem inordinately high. Even if the lender has funds allocated for development, it still will make its presence felt by exacting a high rate of interest for the loans.[109] Thus, the lender can influence both the availability and the cost of new housing.

The lender also exerts its influence by determining which of the many potential developers will receive the necessary financing. High risk development loans require massive amounts of security in the form of collateral and guarantees. The lender virtually always will secure liens on the development property.[110] In addition, the lender may require security interests in the developer's other real or personal property. Lenders will require guarantees from corporate sureties, in the form of payment and performance bonds, or from the developer's partners or principal shareholders and their spouses.[111] Lenders also look to the developer's track record and the experience of his key personnel for a measure of intangible security.[112] These potentially stringent requirements effectively bar the smaller and less experienced development firms from the process.

The lender also can exert its influence on the development decision-making process more directly. An experienced development loan department, for example, can offer the developer a wide range of assistance and expertise in areas ranging from site selection to design, and in

106. *See id.*

107. M. CLAWSON, *supra* note 3, at 100 (quoting S. MAISEL, FINANCING REAL ESTATE 315-16 (1965)).

108. *Id.* Developers often borrow from 80% to more than 100% of the value of the completed development project. *Id.*

109. *See* R. HARRIS, *supra* note 4, at 1-5, 3-6. *See generally* PRESIDENT'S COMMITTEE ON URBAN HOUSING, *supra* note 40, at 131-33 (discussing various problems related to the cost and availability of construction and mortgage financing).

110. *See* R. HARRIS, *supra* note 4, at 3-9.

111. *See id.* at 4-90 to 4-92.

112. *See id.* at 3-12.

marketing of the final product. This assistance is in the best interest of all concerned if it enables the developer to avoid making the types of mistakes that result in failure. The large institutional lender, however, tends to be conservative.[113] For the sake of security, it tends toward the safe and the familiar. Thus, in the name of "sound lending," the lender can dominate the development process. At its best, that domination can result in the increased viability of the project and availability of the product. At its worst, it can result in the perpetuation of mediocrity, stagnation, and social stratification.[114]

4. Buyers

Buyers are the essential final link in the development process. Regardless of what has transpired previously, the development will fail if potential buyers are unwilling to borrow funds and purchase homes. To some extent, the developer can stimulate demand for his product through his choice of location and design, and by his ability to hold costs down. Nevertheless, the purchasing decision is largely a function of the characteristics of the buyers, the need for new housing, and the level of interest rates.[115]

The need for a particular type of housing is dependent upon a variety of characteristics including age, marital status, number of children, occupation, education, and income.[116] Although new home buyers obviously are a diverse lot, certain common characteristics stand out: typical purchasers of new suburban homes tend to be young or middle-aged couples with children, caucasian, and with average or above average incomes.[117]

The factors leading to the purchasing decision are varied: 1) dissatisfaction with present housing because of its physical condition or location; 2) the need or desire for additional space; 3) an increase in income; and 4) a job transfer.[118] Significantly, none of the factors that ordinarily result in the purchase of a home—with the exception of a job transfer—necessarily compels such a decision. Moreover, none of the factors, including a job transfer, requires buyers to purchase new sub-

113. M. CLAWSON, *supra* note 3, at 72.
114. *Id.* at 101.
115. *See id.* at 72.
116. *Id.* at 73.
117. *Id.* at 80-81.
118. *Id.* at 80.

urban homes. Thus, in a very real sense, buyers have it within their collective power to ensure the success of a development or to cause it to fail.

Fortunately, for the other actors in the development process, a number of factors improve their prospects. First, Americans are mobile. Not only do they move frequently,[119] but also they lack significant emotional or psychological ties to a particular neighborhood or city.[120] Second, public policy favors owning rather than renting.[121] A third factor acts as a more direct inducement for buyers to purchase new suburban homes. It is estimated that eighty-five to ninety percent of all homebuyers must finance their purchases.[122] Rightly or wrongly, lenders generally are willing to offer better financing for new homes than for used homes.[123] Finally, most buyers seem to buy new suburban homes because that is what they prefer. It is indisputable that the quality of subdivision developments can be improved. It is equally indisputable that large numbers of used homes are available in all price ranges.[124] Thus, homebuyers clearly have a choice. To the extent that the development process results in quality homes at affordable prices this process should be encouraged, and any decision that may adversely affect the process should be based upon an awareness of its potential effect and made with care.

B. *The Public Sector: Subdivision Approval*

Although the private sector initiates land development, the public sector is intimately involved in the subdivision of land as a result of an almost bewildering array of state and local regulations. Subdivision improvement requirements and guarantees are an integral part of the subdivision approval process that is the focus of this section.

1. Parties and Their Interests

The public side of subdivision development consists of a number of

119. *Id.* at 79.

120. *Id.* at 73.

121. *Id.* at 79.

122. *Id.* at 99.

123. Because mortgage loans are secured by the property being purchased, two factors of significance to the lender are the age and condition of the house. U.S. CONFERENCE OF MAYORS, NAT'L COMMUNITY DEV. ASS'N, URBAN LAND INST., THE PRIVATE DEVELOPMENT PROCESS 7 (1979).

124. *See* M. CLAWSON, *supra* note 3, at 74.

persons and agencies. Sophisticated local governments might have professional planning staffs that are principally responsible for the technical evaluation of a subdivision proposal.[125] Government engineers also evaluate subdivision proposals, making recommendations and imposing requirements concerning subdivision improvements.[126] A variety of local and state agencies might be required to review the subdivision proposal, each with a particular mission to fulfill or existence to justify. Planning commissioners may be appointed or elected and, in some instances, are the officials of the local governing body.[127] Each person or agency brings to the subdivision approval process a certain professional bias that will be reflected in the controls that they seek to impose on the developer.

2. Subdivision Control Laws in Review

a. *State Enabling Laws*

Local governments enact subdivision control laws pursuant to state enabling legislation.[128] Because the states have not adopted a uniform model code for subdivision regulation, a great amount of variation exists among state laws.[129] Some states, such as Oregon,[130] Montana,[131] and Washington,[132] have adopted comprehensive codes for subdivision

125. *See id.* at 91-99.

126. *See* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 424 (discussing the role of engineers and their "rivalry" with planners).

127. *See* 4 R. ANDERSON, *supra* note 5, § 23.05.

128. *See* D. HAGMAN, *supra* note 1, at 138. D. MANDELKER, *supra* note 1, § 9.22. Home rule governments present a different situation because their powers may be greater than those of local governments that derive their powers from enabling statutes. *See* Moore v. City of Boulder, 29 Colo. App. 248, 253-54, 484 P.2d 134, 136-37 (1971) (local home rule zoning powers were greater than those granted in the state enabling statute). Although express enabling language may not be necessary before a local government can regulate subdivisions, a local government must pass local regulations before it can control subdivisions. See R. FREILICH & P. LEVI, *supra* note 1, at 28.

129. *See* R. FREILICH & P. LEVI, *supra* note 1, at 2-3. Several model codes in addition to the Standard City Planning Enabling Act have been promulgated: The Municipal Planning Enabling Act by Bassett and Williams; The Municipal Subdivision Regulation Act by Bettman; Model Regulations for the Control of Land Subdivision by Freilich and Levi; and the Model Land Development Code by the American Law Institute. The various models are discussed in R. FREILICH & P. LEVI, *supra* note 1, at 3.

130. *See* OR. REV. STAT. §§ 92.010-.990 (1983).

131. *See* MONT. CODE ANN. §§ 76-3-101 to -614 (1983).

132. *See* WASH. REV. CODE ANN. §§ 58.17.010-.920 (Supp. 1984).

regulation, while others, such as Texas,[133] Utah,[134] and Alaska,[135] have enacted relatively few provisions that often are scattered throughout their codes. State enabling statutes may set maximum standards that can be applied to subdivisions; or conversely, minimum standards that permit local governments to regulate more restrictively.[136]

b. *Purposes of Subdivision Control*

Subdivision control laws are designed to serve a variety of purposes. The original purpose of subdivision regulations, still found in all state laws, is the proper mapping and recordation of subdivided lands.[137] Thus, the basic element of subdivision regulation is that no land within any subdivision may be transferred without first recording a subdivision plat.[138] The developer, however, may not record the plat until the local planning authority or governing body, or both, approve the subdivision.[139] The proper recordation of subdivision plats should facilitate land transfers and government real property taxation.[140]

A second early purpose of subdivision control laws that continues today is the proper laying out of streets and roads.[141] Some state statutes evidence this purpose of subdivision control by requiring approval of a subdivision plat only if the local government has adopted a master street plan.[142] Local codes also manifest the concern for streets and roads with elaborate standards for the grading, paving, and widening of subdivision roads.

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133. *See* TEX. STAT. ANN. art. 6626 (Vernon 1969 & Supp. 1984); art. 974a (Vernon 1963 & Supp. 1982); art. 970a (Vernon 1963).

134. *See* UTAH CODE ANN. §§ 10-9-25 to -30 (1977 & Supp. 1983); § 17-21-8 (1973); §§ 17-27-1 to -27 (1973 & Supp. 1983); §§ 57-5-1 to -8 (1974).

135. *See* ALASKA STAT. §§ 40.15.010-.190 (1971 & Supp. 1984).

136. *See, e.g.*, CAL. GOV'T CODE § 66411 (Deering 1979) (authorizing local governments to regulate subdivisions other than those defined in the Subdivision Map Act, but any regulations cannot be more restrictive than those found in the Act).

137. *See* D. MANDELKER, *supra* note 1, § 9.2; Note, *Platting, Planning & Protection—A Summary of Subdivision Statutes*, 36 N.Y.U. L. REV. 1205, 1206 (1961).

138. *See* 4 R. ANDERSON, *supra* note 5, § 23.04; TEXAS STAT. ANN. art. 6626 (Vernon 1969 & Supp. 1984).

139. *See* Note, *Land Subdivision Control*, 65 HARV. L. REV. 1226, 1235 (1952); ALASKA STAT. § 40.15.010 (1971).

140. *See* D. HAGMAN, *supra* note 1, § 134.

141. *See* 4 R. ANDERSON, *supra* note 5, § 23.32; D. MANDELKER, *supra* note 1, § 9 2.

142. *See* D. HAGMAN, *supra* note 1, § 135; UTAH CODE ANN. § 10-9-25 (1977).

A third and more recent purpose of subdivision regulations is the assurance of quality development and avoidance of environmental degradation. Subdivision improvement requirements are imposed in part to guarantee an adequate infrastructure for the residential development and, in part, to ensure that the development does not present environmental hazards.[143] Thus, for example, assurances by the developer that he will provide an adequate central water system ensure that the homebuyer will have a water supply while also permitting appropriate government agencies to protect water quality. Subdivision regulations consequently protect both homebuyers and their neighbors.[144]

Finally, subdivision control laws, particularly improvement requirements, permit local governments to shift the cost of providing public improvements from themselves to developers and, ultimately, to the homebuyers in the development. The imposition of subdivision improvement costs on the developer, along with the frequent performance guarantee requirements, represent a continuation of local government reaction to the harmful consequences of premature subdivision that befell them in the 1920s and 1930s. Rather than limit subdivison development altogether, a potentially unconstitutional option,[145] local governments generally have permitted growth, but shifted the cost of capital improvement to the developer.[146]

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143. *See* S. SEIDEL, *supra* note 1, at 18-19; Melli, *supra* note 41, at 392-95.

144. *See* R. FREILICH & P. LEVI, *supra* note 1, at 7-8; COLO. REV. STAT. § 30-28-133(6)(a) (1973 & Supp. 1982).

145. *See* 1 P. ROHAN, *supra* note 17, § 4.01[3].

146. A more subtle purpose of subdivision control laws is business regulation. *See* R. YEARWOOD, *supra* note 1, at 59-60, 120-21; McPherson, *supra* note 32, at 477. Subdivision control laws impose financial burdens that only financially stable developers can meet. *See* B. ROGAL, *supra* note 12, at 3. Additionally, these laws establish a bureaucratic structure in which those that successfully "politicize" the process can obtain more from government officials than can outsiders. *See* R. ELLICKSON & A. TARLOCK, *supra* note 2, at 236-38 (discussing lobbyists and dealmaking in zoning decisions). Controls on developers also can have a positive effect. They encourage the developer to come up with better cost information on the development, which, in turn, should encourage the developer to understand better the likelihood of successfully marketing his development. *See* S. SEIDEL, *supra* note 1, at 124-25. An argument also can be made that controls limit development to those businesses that are most likely to complete a quality project. *See* R. YEARWOOD, *supra* note 1, at 121-22; T. PATTERSON, *supra* note 35, at 93. The fact that many developers may be precluded from entering the market because of financial barriers also means that persons in the market may be insulated from the effects of competition.

c. *Constitutionality of Subdivision Control*

In general, the courts have upheld the constitutionality of subdivision control laws.[147] The three most frequent challenges to these laws are that they deny a landowner due process of law, they effect a taking of property without just compensation, and that they violate equal protection guarantees. The due process challenge is predicated on the theory that any governmental regulation must bear at least a reasonable relationship to the purpose of the legislation and that the local regulation, on its face or as applied, is unreasonable.[148] The taking argument is based either on the loss in value to the developer if he is forced to incur significant costs in installing improvements or on the required dedication of otherwise private improvements.[149] Equal protection guarantees are raised when only a given class of land development is subject to regulation or when several classes are treated differently.[150] Courts experience little difficulty in rejecting the constitutional arguments in most challenges to subdivision control laws.[151]

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147. *See* B. ROGAL, *supra* note 12, at 2. *See generally* Note, *supra* note 17, at 279-94.

148. *See* 2 P. ROHAN, *supra* note 17, §§ 9.01[3], 9.02.

149. *See* R. FREILICH & P. LEVI, *supra* note 1, at 15-16; R. ELLICKSON & A. TARLOCK, *supra* note 2, at 63.

150. *See* 2 P. ROHAN, *supra* note 17, § 9.02.

151. Some commentators assert that the government has authority under the police power to regulate property for the benefit of public health, welfare, and safety. *See* 4 R. ANDERSON, *supra* note 5, § 23.04; R. FREILICH & P. LEVI, *supra* note 1, at 9. Thus, subdivision regulations are constitutional even though they diminish the value of a person's property because they are a reasonable means for promoting public welfare. *See* R. FREILICH & P. LEVI, *supra* note 1, at 10-11. The regulations do not effect a taking of property simply because they diminish the value of the developer's property. As Justice Holmes stressed in his classic statement in Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922), government hardly could continue if it had to compensate a property owner every time a government regulation diminished the value of his property. *Id.* at 413. The taking of property is a legal conclusion based on the nature of the government regulation, the loss in value to the property owner, and the public benefit gained from the regulation. *See* Agins v. City of Tiburon, 447 U.S. 255, 260-61 (1980). The equal protection challenge also is unavailing because, with no suspect classes or fundamental rights involved, the classification only must be a rational means for accomplishing the purposes of the legislation. *See* Delight, Inc. v. Baltimore County, 624 F.2d 12, 14 (4th Cir. 1980) (subdivision regulations did not involve an inherently suspect distinction).

Admittedly, dedication requirements and off-site improvement requirements have given the courts more difficulty than any other aspect of subdivision control. Off-site improvements refer to improvements that are not within the boundaries of the subdivision. *See* 4 R. ANDERSON, *supra* note 5, § 23.36. D. MANDELKER, *supra* note 1, § 9.12. Dedications or in lieu fees are discussed in Comment, *supra* note 17, at 319-20. Rather than relying on a straightforward recognition that the police power is a sufficient

d. *The Relationship Between Planning and Zoning*

Subdivision control laws are related to zoning, but serve different purposes. While zoning establishes districts in which various uses of land may be made, subdivision control is concerned more with the manner in which a given use is made.[152] Thus, although zoning regulations may establish height, floor space, density, and set-back requirements, subdivision controls regulate more particularized features of development such as landscaping, road surfaces, drainage requirements, and access.[153] Because many subdivision proposals implicate both zoning and subdivision controls, a planning commission may have the authority to modify minor zoning requirements to facilitate more sensible development.[154] A subdivision proposal, however, also may

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justification for these requirements, the courts have fashioned more sophisticated, or sophistic, theories. First, some commentators argue that the subdivision of land is a privilege that the local government can bestow conditionally on a landowner. *See* Johnston, *Constitutionality of Subdivision Control Exactions: The Quest for a Rationale*, 52 CORNELL L.Q. 871, 881-85 (1967). *But see* D. HAGMAN, *supra* note 1, § 136 (arguing that privilege theory is illusory); Note, *supra* note 17, at 283, 289 (asserting that the privilege test is inadequate). Thus, the assumption is made that a landowner has no inherent right to develop his property and that the government must grant such a right. In truth, an intrinsic right to develop land exists and in jurisdictions with no subdivision control authority, the government cannot impinge on the developer's right. *See* Bella Vista Ranches, Inc. v. City of Sierra Vista, 126 Ariz. 142, 143, 613 P.2d 302, 303 (Ariz. App. 1980). The right is not absolute, however, and the government, acting pursuant to validly enacted legislation, can limit the developer's right for the public welfare. *See* R. YEARWOOD, *supra* note 1, at 84.

A second theory supporting subdivision controls, similar to the first, is that the subdivision of land is a voluntary act and that no taking occurs because a landowner can avoid the regulations by declining to subdivide. *See* Johnston, *supra*, at 876-81. That theory justifies any government regulation of business because the businessman voluntarily entered the market and can just as easily have avoided the regulations by abstaining from the regulated business. A regulation is not constitutional simply because a person can abstain from engaging in the regulated conduct. The regulation still must be reasonable and relate to promotion of the public welfare. The failings of the privilege and voluntary act theories led the courts to shift their emphasis to the police power as a sufficient basis for upholding subdivision regulations. *See* Note, *supra* note 139, at 1232-33; Note, *supra* note 17, at 282-88. The merging of the theories is based on the fact that the courts will not uphold a regulation if they perceive it as being unreasonable. *See* D. HAGMAN, *supra* note 1, § 138. To determine the reasonableness of a regulation it is necessary to compare the private interests of the developer with the public interests sought to be served by the legislation. *See* Reps & Smith, *Control of Urban Land Subdivision*, 14 SYRACUSE L. REV. 405, 406 (1963).

152. *See* D. HAGMAN, *supra* note 1, § 135; Note, *supra* note 17, at 270 n.6.

153. D. HAGMAN, *supra* note 1, § 135.

154. *See* 4 R. ANDERSON, *supra* note 5, § 23.22. Sections 14 and 16 of the Standard City Planning Enabling Act actually provide planning authorities with control over

necessitate changes in zoning classification—for example, from single-family to multiple-family dwellings. In these instances, some jurisdictions provide a consolidated procedure for considering both the zoning change and the subdivision proposal.

e. *Master Plans and Subdivision Control*

Many jurisdictions have established master plans that serve as a blueprint to guide community growth and development.[155] The majority of these jurisdictions do not require that a developer's subdivision decisions conform strictly with the master plan.[156] Thus, the local government has some flexibility to deal with particular situations as they arise. If a government establishes a pattern for dealing with developers, however, a significant deviation from this pattern may lead to a successful challenge by the affected developer.

3. The Subdivision Approval Process

Subdivision improvement requirements are imposed on the developer during the subdivision approval process. Although many variations exist among state laws and local practices, some generalizations about the process can be made. The essence of subdivision control is that the developer cannot convey subdivided land without recording a subdivision plat, and that the developer cannot record the subdivision plat until it has been approved by the local planning commission or government body, or by both.[157]

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matters also dealt with by zoning authorities. *See* Krasnowiecki, *Planned Unit Development: A Challenge to Established Theory and Practice of Land Use Control*, 114 U. PA. L. REV. 47, 84-85 (1965).

155. *See* Nelson, *The Master Plan and Subdivision Control*, 16 ME. L. REV. 107, 107 (1964).

156. *See* D. HAGMAN, *supra* note 1, § 135.

157. *See* 4 R. ANDERSON, *supra* note 5, § 23.05. *Compare* ARIZ. REV. STAT. ANN. §§ 9-463.01.H, 11-806.01.B (1977 & Supp. 1983) (authority vested in legislative body) *with* OR. REV. STAT. § 92.044(2)(a) (1983) (authority vested in planning commission with right of appeal to the legislative body). The authority of a city government to control subdivision development generally extends beyond municipal boundaries and into the unincorporated areas of the county. The most common extraterritorial reach is three miles. *See, e.g.*, ARIZ. REV. STAT. ANN. § 9-463.04 (1977); NEV. REV. STAT. § 278.340 (1981). Other jurisdictions extend extraterritorial power to six miles. *See, e.g.*, OR. REV. STAT. § 92.042 (1983). Still others extend extraterritorial powers on the basis of the size of the city. *See, e.g.*, N.M. STAT. ANN. § 3-20-5.A (1978); TEX. STAT. ANN. art. 970a, 3A(1)-(5) (Vernon 1963). Extraterritorial power is significant because it provides cities with control over areas that they eventually may annex. *See* 5 N. WILLIAMS, *supra* note 1, § 156.03. Extraterritorial authority, however, may place the

a. *Defining a Subdivision*

Subdivision controls are triggered, not surprisingly, when a developer subdivides or proposes to subdivide land. Subdivision is the process of dividing a tract of land into a number of lots, parcels, sub-tracts or other similar units.[158] Some state laws define subdivision to include division into two or more parts,[159] while others require three, four, or even five parts to initiate the approval process.[160] Not all subdivisions fall within the purview of control laws. Generally, local governments limit subdivision controls to divisions for the purpose of immediate or future sale or building development, and, even further, to divisions for residential use.[161] Several states have adopted broader definitions that encompass the leasing of subdivided lands, and the development of condominiums and cooperative apartments.[162]

Some states except certain subdivisions from control laws if they result in large tracts or are used for certain designated purposes such as agriculture or commercial development.[163] Exceptions also may exist for conveyances resulting from testamentary dispositions,[164] financing agreements,[165] transfers of mineral interests,[166] and boundary line ad-

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city in conflict with the county government that also regulates subdivision development. A scheme then must be provided to work out such conflicts. *See* 4 R. ANDERSON, *supra* note 5, § 23.06. Additionally, an overlap of authority may exist between or among city governments. Often the state allows the city with the greatest population to control the subdivision. *See, e.g.*, N.M. STAT. ANN. § 3-20-5.B (1978).

158. See D. MANDELKER, *supra* note 1, § 9.5. The use of terms other than "lot" is important because the term "lot" may be given a restrictive meaning, allowing other subdivisions to evade the effect of the law. *See* 4 R. ANDERSON, *supra* note 5, § 23.02.

159. *See, e.g.*, ARIZ. REV. STAT. ANN. § 9-463.02 (1977) (law applies to division into two or more lots if a new road will be created); N.M. STAT. ANN. § 3-20-1 (1983) (law applies to division into two or more lots if done for one of five listed purposes).

160. *See* NEV. REV. STAT. § 278.320 (1981) (five or more lots); OR. REV. STAT. § 92.010(12) (1983) (four or more lots); WYO. STAT. § 15-1-501(iii) (1977) (three or more lots). Montana has an interesting provision defining subdivision to include a division of land into *one* or more parcels of less than 20 acres. *See* MONT. CODE ANN. § 76-3-103(15) (1983).

161. *See, e.g.*, IDAHO CODE § 50-1301.3 (1980).

162. *See, e.g.*, MONT. CODE ANN. § 76-3-103(15) (1983) (including any conveyance for purposes including condominiums, camping, and mobile homes).

163. *See, e.g.*, WYO. STAT. § 18-5-303 (1977).

164. *See, e.g.*, WASH. REV. CODE ANN. § 58.17.040(3) (1983).

165. *See, e.g.*, MONT. CODE ANN. § 76-3-201(2) (1983).

166. *Id.* § 76-3-201(3).

justments.[167] State law and local ordinances may make partial exceptions by subjecting minor subdivisions to expedited approval and to less stringent requirements than are imposed on other subdivisions.[168]

b. *Stages in the Approval Process*

Although most state statutes outline a two-step process for subdivision approval,[169] many local governments include an additional preliminary step. When a developer proposes to subdivide land, local governments may require him to give notice to the local planning commission for the purpose of conducting a preapplication conference.[170] In that conference the planning commission will familiarize the developer with local regulations, and the developer will provide the commission with a basic idea of the proposed development project. The planning commission and the developer can work out obvious problems at this informal stage in the approval process.

The first formal stage in subdivision approval is the submission of a preliminary plat. State law and local ordinances require that the developer submit a drawing of the proposed development that conforms to a variety of mapping and survey requirements.[171] The developer must include necessary improvements on the plat and must indicate which improvements he will dedicate to public use.[172] The planning commission and its staff, if it exists, review the plat and refer it to several state

167. *See, e.g.*, ARIZ. REV. STAT. ANN. § 9-463.02.C.1 (1977).

168. *See, e.g.*, MONT. CODE ANN. § 76-3-505 (1983) (five or fewer parcels); NEV. REV. STAT. §§ 278.461-.462 (1981) (four or fewer lots); UTAH CODE ANN. § 10-9-26 (1983) (10 or fewer lots). Provisions for small subdivisions are important, but care must be taken so that the provisions are not used to avoid the more stringent requirements applied to larger subdivisions. Many statutes note that exceptions to the subdivision control laws do not apply if the exception is used to evade the law. *See, e.g.*, COLO. REV. STAT. § 30-28-101(10)(c) (1982).

169. *See* 4 R. ANDERSON, *supra* note 5, § 23.11; *see, e.g.*, ARIZ. REV. STAT. ANN. §§ 9-463.01.C.1-.2 (1983); COLO. REV. STAT. § 30-28-133(3) (1973 & Supp. 1982). Other states allow the local government to determine the process for subdivision approval. *See* IDAHO CODE § 67-6513 (1980).

170. D. MANDELKER, *supra* note 1, § 9.4. Preapplication is largely a creation of the local government. *See* TETON COUNTY, WYO., COMPREHENSIVE PLAN AND IMPLEMENTATION PROGRAM ch. 11, §§ 2, 3 (1980) (providing for an informal conference before submission of a preliminary plat).

171. *See, e.g.*, IDAHO CODE §§ 50-1303, -1304 (1980).

172. *See, e.g.*, PHOENIX SUBDIVISION ORDINANCE art. 11, §§ 32-22, -23 (requiring submission of "Proposed Conditions Data," which include designation of all land that the developer will dedicate or reserve, and "Proposed Utility Methods").

and local agencies.[173] These agencies may require the developer to obtain a number of certificates regarding the adequacy of the proposed development's infrastructure.[174] The planning commission or local governing body then may approve, disapprove, or conditionally approve the preliminary plat after a properly noticed hearing.[175] State statutes usually require that reasons for disapproval be noted on the record.[176] Additionally, the final decision, whether made by the planning commission or local governing body, is subject to judicial review.[177] At this stage, the planning commission or local governing body imposes subdivision requirements, and conditions final approval upon either completion of the improvements or the developer's posting of a surety bond or other security to guarantee completion after final approval.

Following preliminary plat approval, the developer generally has one year within which to submit a final plat for approval.[178] The final plat must conform substantially to the preliminary plat and any conditions that the planning commission or local governing body imposed on the developer.[179] Most often, the developer need only comply with regulations and ordinances that were in effect at the time of preliminary ap-

173. *See, e.g.*, COLO. REV. STAT. § 30-28-136(1) (1973) (requiring the Board of County Commissioners to submit a preliminary plat for review by appropriate school districts; counties and municipalities within two miles of the proposed development; utility, local improvement, and special service districts; the Colorado State Forest Service as applicable; as well as five other agencies when applicable).

174. *See, e.g.*, ARIZ. REV. STAT. ANN. § 463.01I (1983) (requiring a certificate of assured water supply when the proposed subdivision is in a groundwater active management area).

175. *See* 4 R. ANDERSON, *supra* note 5, § 23.12. Some statutes clearly specify a hearing on the preliminary plat, see WASH. REV. CODE ANN. § 58.17.090 (1983), while others do not. *See* ALASKA STAT. § 40.15.100 (1971), *repealed by* § 1, ch. 118 S.L.A. (1972). Due process may require notice and an opportunity to be heard even when not required by statute. *See* Fasano v. Board of County Comm'rs, 264 Or. 574, 588, 507 P.2d 23, 30 (1973).

176. *See* 4 R. ANDERSON, *supra* note 5, § 23.15; ARIZ. REV. STAT. ANN. § 11-806.01.D (1983) (mandating a decision on the record of the Board of County Supervisors when a plat is approved or refused).

177. *See*, e.g., WASH. REV. CODE ANN. § 58.17.180 (1983) (permitting any city, town, or county property owner who is injured by a decision approving or disapproving a subdivision plat to bring an action).

178. *See, e.g.*, NEV. REV. STAT. § 278.360(1) (1981) (permitting, however, a one year extension); *id.* § 278.360(3).

179. *See, e.g.*, MONT. CODE ANN. § 76-3-611(1)(a) (1983); OR. REV. STAT. § 92.040 (1983).

proval,[180] but a few states require that the developer's final plat must comply with all laws in effect at the time that the final plat is approved.[181] Thus, the developer in the latter group of states does not obtain any vested right to develop after preliminary plat approval.[182] If the final plat is approved, the developer may record the plat and he then is legally entitled to convey property in the subdivision.

Several states set time limits within which the local government

180. *See, e.g.*, MONT. CODE ANN. § 76-3-610(2) (1983) (after tentative approval the government can impose no new requirements on the developer); OR. REV. STAT. § 92.040 (1983) (the final plat must be accepted if it conforms to preliminary plat); WASH. REV. CODE ANN. § 58.17.170 (1983) (the final plat must comply with all regulations in effect at time of preliminary plat approval). Washington also provides that after final approval the subdivision will be protected for a period of five years from changes in statutes, ordinances, and regulations unless the subdivision poses a serious threat to public health and safety. *Id.*

181. *See, e.g.*, NEV. REV. STAT. § 278.380 (1981) (the final plat must comply with regulations in effect at the time of final approval).

182. Unless otherwise provided, the general rule appears to be that the local government can force the developer to comply with changes in statutes, ordinances, or regulations that occur after preliminary approval. *See* 4 R. ANDERSON, *supra* note 5, § 23.23. Many statutes and local ordinances do not specify clearly the effect of preliminary plat approval. *See* Krasnowiecki, *supra* note 152, at 95. Thus, the courts usually require that the developer has made a substantial investment in the project or has begun construction before the courts will find a vested right to develop free from the effects of changed laws. *See* Reps & Smith, *supra* note 151, at 412-13. Vesting is a legal conclusion based on a balancing of public and private interests. Presumably, one purpose of a preliminary plat is to inform the developer of what he must do and pay to gain government approval. The developer makes predictions concerning his expected profit margin on the basis of the requirements imposed during preliminary approval. On the other hand, the government has an interest in promoting the public health and safety and should not permit a subdivision project that will endanger the public. A balancing of these interests should permit the government to impose new conditions on the developer after preliminary approval so long as substantial reliance in the form of a monetary investment has not occurred. Even after vesting, however, the government can impose new conditions if required by the public health and safety, but then the government should compensate the developer for any loss.

In Western Land Equities v. City of Logan, 617 P.2d 388, 391 (Utah 1980), the Utah Supreme Court fashioned one of the most prodevelopment vesting rules when the court held that a developer acquired a vested right if: 1) He filed a substantially conforming development plan prior to a change in the law; 2) application of the change is not necessary to protect public health and safety; and 3) the change was not pending when the developer filed his plan. The right to develop vests without any substantial investment or initiation of construction by the developer. If the plan will jeopardize public health and safety, however, the right does not vest. It is this last aspect of the Utah test that is troublesome because it suggests that a local government can deny a developer the right to develop without compensation even though he has incurred significant expenses. *See* Grow & Johnson, *Vested Rights and Land Planning Process*, 9 UTAH PLANNER, Nov. 1983, at 3.

must act on preliminary and final plats; if the local government takes no action, the plat is deemed approved.[183] Approval of the preliminary or final plat does not constitute an acceptance by the local government of dedicated improvements.[184] That acceptance occurs when the local government makes a formal decision to accept the dedication. At this time the local government becomes responsible for maintaining the improvements.[185]

c. *Enforcement Methods*

Subdivision controls are enforced by several methods. The developer or his agent will be guilty of a misdemeanor and subject to a fine or a jail term, or both, for each lot that they convey in violation of the law.[186] In addition, the local government can enjoin transfers.[187] The local government may remove subdivision plats that are recorded illegally from the records[188] and may sanction the local recorder for recording an unapproved subdivision.[189] In some jurisdictions, a purchaser of a lot or home in an unapproved subdivision may rescind the sale or seek damages from the seller.[190] The government may refuse to issue building permits or certificates of occupancy and even may abate illegal structures unless the home or lot purchaser is a bona fide purchaser without notice of the subdivision's illegal status.[191] Similarly, the government may refuse to extend utilities to the illegal subdivision.[192]

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183. *See, e.g.*, NEV. REV. STAT. § 278.350 (1981). Most statutes provide that a plat will be "deemed" approved. It is doubtful, however, that a court will permit a subdivision project to proceed if it will seriously jeopardize public health and safety.

184. *See* R. YEARWOOD, *supra* note 1, at 92.

185. *See* D. HAGMAN, *supra* note 1, § 140.

186. *See, e.g.*, N.M. STAT. ANN. § 3-26-14 (1978); WYO. STAT. § 15-1-511 (1977).

187. *Id.* Several states permit the developer to sell lots after preliminary approval, but the buyer must be given notice that final approval has not been received and the purchase price may have to be escrowed pending final approval. *See* NEV. REV. STAT. § 278.353 (1981); WASH. REV. CODE ANN. § 58.17.205 (1983).

188. *See, e.g.*, WASH. REV. CODE ANN. § 58.17.190 (1983) (permitting an action by the prosecuting attorney to remove an unapproved plat from the records).

189. *See, e.g.*, UTAH CODE ANN. § 17-21-8 (1977).

190. *See, e.g.*, OR. REV. STAT. § 92.018 (1983).

191. *See, e.g.*, COLO. REV. STAT. § 31-23-216.5 (1982). *See also* D. MANDELKER, *supra* note 1, § 9.8 (discussing the legality of these measures).

192. *See, e.g.*, TEX. STAT. ANN. art. 974a, § 8 (Vernon 1963 & Supp. 1982). Occasionally, subdividers attempt to avoid subdivision requirements by transferring land by a metes and bounds description rather than by reference to a subdivision plat. Thus,

4. Subdivision Improvement Requirements and Guarantees

a. *Required Improvements*

Although a developer may obtain approval of a final plat if all subdivision improvements are completed, normally the local government accepts a surety bond or other security to guarantee completion of the improvements after final approval. Improvements that the local government requires the developer to construct and install include roads, drainage facilities, water and sewage systems, landscaping, utilities, fire protection equipment, and street signs. The number and types of subdivision improvements that a local government can require a developer to complete are limited only by the imaginations of the members of the planning commission and the local governing body.[193] Most recently, local governments have required developers to undertake off-site improvements[194] and, when necessary, to obtain easements across adjoin-

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many states now prohibit transfer by a metes and bounds description if the subdivision has not been approved. *See, e.g.*, N.M. STAT. ANN. § 3-20-14 (1978).

193. *See* 7 P. ROHAN, *supra* note 17, § 45.04[8]. In order to constrain local government action and prevent an unconstitutional delegation of power, standards should exist for determining what improvements the local government can require. *See* 4 R. ANDERSON, *supra* note 5, § 23.08. Occasionally, state statutes specify the improvements that local governments can require. *See, e.g.*, MONT. CODE ANN. § 76-3-501 (1983) (lists numerous types of requirements that local government may require). In other instances, the state grants broad authority to the local government. *See, e.g.*, NEV. REV. STAT. § 278.462.2 (1983) (local government may require such improvements as are "reasonably necessary" for small subdivisions). Most often the local government must infer the list of permissible improvements from the purposes of the state statute. *See, e.g.*, N.M. STAT. ANN. § 3-19-6.B(4) (1978); WASH. REV. CODE ANN. § 58.17.110 (1983).

Local ordinances also vary in the number and degree of specificity regarding improvements. *Compare* ASPEN, COLO., CODE § 20-16(a) (Supp. 15 & 11) (listing 16 required improvements) *with* THORNTON, COLO., CODE §§ 62-13.B, .C (1983) (which appears to limit required improvements to street improvements, water and sewer mains, and fire hydrants). Because state law and the local ordinance must authorize any given improvement, a "catch-all" provision may be included in the law. *See* SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.5(12) (1982) (authorizing the planning commission to require any other reasonable improvement). Such a provision may be constitutionally defective for failing to give a developer adequate notice of what is required of him and for failing to constrain government action. A developer may not challenge the government's action, however, because he has an incentive to comply if he wants to avoid delays and possible future harassment by the government. *See* D. HAGMAN, *supra* note 1, § 138.

194. *See, e.g.*, 4 R. ANDERSON, *supra* note 5, § 23.36. The term "off-site improvement" is used in two different ways: off the subdivision site or off the lots in the subdivision. For purposes of this Article, off-site improvements refer to those improvements not within the boundaries of the subdivision. *See id.* Note, *supra* note 17, at 276-77.

ing land.[195] The developer must design improvements according to government standards and specifications, and these will not be accepted unless approved by a local engineer.[196] Some jurisdictions permit variances from required improvements when the requirements will result in extreme hardship to the developer and the variance will not threaten the public interest.[197]

b. *Security Methods*

Acceptable security methods vary by jurisdiction with the most common requirement being a corporate surety bond "or other adequate security."[198] Because the subdivision is subject to approval by a number of agencies, the developer may be required to post more than one bond.[199] Most jurisdictions, however, permit a consolidated bond for all of the required improvements. The usual term of the bond or security agreement is two years,[200] meaning that the developer has two years within which to complete the improvements. If, after two years, the developer fails to complete the improvements, the local government may declare a default unless the parties extend the term of the bond or agreement.[201] Other adequate security includes cash or property es-

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Several local governments have adopted provisions to reimburse the developer for offsite improvements that others will use or for excess capacity improvements, such as a water main. *See* PROVO, UTAH, SUBDIVISION REGULATIONS § 15.18.040 (1978).

195. *See, e.g.*, SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.5(3) (1982) (requiring easements for local public utilities).

196. *See, e.g.*, TETON COUNTY, WYO., COMPREHENSIVE PLAN AND IMPLEMENTATION PROGRAM ch. IV, § 3 (1980) (requiring a signed statement by the county engineer or other authorized individual that improvements meet local standards).

197. *See, e.g.*, SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.5(13) (1982) (permitting variances where, because of topographical or other "extreme physical conditions," unnecessary hardship would result). *See also* D. MANDELKER, *supra* note 1, § 9.10. Although variances are necessary to deal with unforeseen difficulties, local governments must subject them to standards and grant them only in extreme circumstances. *See* R. FREILICH & P. LEVI, *supra* note 1, at 30.

198. *See, e.g.*, ARIZ. REV. STAT. ANN. § 9-463.01.C.8 (1983) (requiring the posting of "performance bonds, assurances or such other security as may be appropriate"). Similarly, language in local ordinances may be vague. *See* WASATCH COUNTY, UTAH, DEVELOPMENT CODE 91 (requiring a "bond or other financial assurance satisfactory to the Board of County Commissioners").

199. *See, e.g.*, OR. REV. STAT. §§ 92.090(4)(b), (5)(b) (1983) (requiring a bond for water improvement and a bond for sewerage improvement). *See also* S. SEIDEL, *supra* note 1, at 21 (Maryland developer required to obtain four bonds).

200. *See, e.g.*, WASATCH COUNTY, UTAH, DEVELOPMENT CODE 92.

201. *Id.*

crows, letters of credit, or commitments of funds by lenders.[202] The developer also may use a sequential approval process by which the developer can record only those portions of the development for which improvements are completed on a final plat.[203] Thus, the developer does not, in fact, provide security except to the extent that the local government will not approve the balance of the subdivision if the developer does not complete the improvements.

c. *The Amount of Security*

The local government bases the amount of the bond or other security on a cost estimate of the required improvements and may predicate that figure on the developer's estimates after review by the planning authority.[204] Some jurisdictions provide for a margin of error by requiring that the bond or security be equal to one hundred ten or one hundred twenty percent of the projected cost of improvements.[205] As the developer completes improvements, the amount of the bond or security may be reduced, usually to a minimum of ten percent of the security.[206] Thus, the developer avoids the cost of tying up large sums of money and the local government retains some security in case of an ultimate default.

d. *Maintenance Bonds and Other Fees*

The local government also may require a maintenance bond to ensure that the improvements are sound and to pay for any maintenance costs for a limited time after the local government accepts the improvements.[207] Most governments require the developer to pay fees to offset

202. *See, e.g.*, COLO. REV. STAT. § 30-28-101(11) (1973) (listing variety of assurance methods); N.M. STAT. ANN. § 3-19-6.C (1978) (listing three methods to assure completion of improvements including installation by the government and an assessment of lots). A local government may limit the acceptable security, possibly indicating a past bad experience with other forms. *See* THORNTON, COLO., CODE § 62-13.A (1983) (requiring a surety bond or sequential approval); ASPEN, COLO., CODE § 20-16(c)(1) (Supp. 11) (requiring cash escrow, a sight draft, or letter of commitment).

203. *See* THORNTON, COLO., CODE § 62-13.A (1983); S. SEIDEL, *supra* note 1, at 136

204. *See, e.g.*, WASATCH COUNTY, UTAH, DEVELOPMENT CODE 92 (bond amount determined by the Board of County Commissioners based on the developer's estimated cost of construction).

205. *Id.* (110%); SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.4(7)(3) (1982) (120%).

206. *See, e.g.*, COLO. REV. STAT. § 30-28-137(1) (1973).

207. *See* Freilich & Levi, *Model Regulations for the Control of Land Subdivision*, 36

the cost of inspecting improvements during construction and installation of the improvements and prior to acceptance.[208] After the developer notifies the government that improvements are complete, the improvements will be inspected and, if acceptable to the local government, the security will be released within a few days.[209]

e. *Government Supervision and Acceptance of Improvements*

Regardless of the form chosen to secure completion of subdivision improvements, the local government must perform a supervisory function to assure itself that the developer has constructed and completed the improvements in compliance with applicable regulations and specifications.[210] This supervisory function usually constitutes a three-step process that includes inspection, approval, and acceptance of the improvements.[211]

When the developer completes or substantially completes all or part of the required improvements, he may notify the municipal engineer and request an inspection.[212] The engineer then must perform a site inspection and prepare a detailed report.[213] Ordinarily, the inspection must be made within a specified time after a request is submitted.[214]

The engineer's report indicates whether the improvements are approved, partially approved, or rejected and can be used to serve several

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MO. L. REV. 1, 17-18 (1973). As an alternative to a bond, the local government may retain a percentage of the security after completion of improvements to guard against defects in workmanship. *See* SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.4(7)(3) (1982) (retaining 10% of the land or escrow as security).

208. *See* SUMMIT COUNTY, UTAH, DEVELOPMENT CODE ch. 13.10 (1982) (authorizing reasonable fees). Fees must bear a reasonable relationship to the cost of administration and inspection. *See* 4 R. ANDERSON, *supra* note 5, § 23.45.

209. *See, e.g.*, TETON COUNTY, WYO., COMPREHENSIVE PLAN AND IMPLEMENTATION PROGRAM ch. IV, § 4 (1980) (requiring release of security within seven days of inspection if improvements meet standards).

210. *See supra* notes 196-97 and accompanying text.

211. *See* B. ROGAL, *supra* note 12, at 11.

212. *E.g.*, Township of Barnegat v. DCA of N.J., Inc., 181 N.J. Super. 394, 397, 437 A.2d 909, 910 (App. Div. 1981); Mertz v. Lakatos, 33 Pa. Commw. 230, 233-34, 381 A.2d 497, 499 (1978).

213. The municipality ordinarily will charge an inspection fee of 1% to 2% of the estimated value of the improvements.

214. *E.g.*, Township of Barnegat v. DCA of N.J., Inc., 181 N.J. Super. 394, 397, 437 A.2d 909, 910 (App. Div. 1981) (inspection and report must be made within 65 days); Mertz v. Lakatos, 33 Pa. Commw. 230, 236, 381 A.2d 497, 499 (1978) (inspection and report must be made within 40 days).

purposes. If the engineer rejects any of the improvements, the report sets out the reasons for rejection and the steps necessary to gain approval. Additionally, the report serves to notify the surety, lender, or escrow agent that a portion of the improvements have been accepted, thus permitting the partial release of the bond or escrowed funds, or the disbursement of set-aside funds.[215] Finally, the engineer forwards a copy of the report to the municipal agency charged with accepting dedication of the completed improvements. Generally, neither the approval itself nor the release or partial release of security constitutes an acceptance of dedication.[216] A complete failure to approve or reject in some cases, however, may result in automatic approval.[217]

Acceptance of dedication constitutes the final step in the supervisory process and results in the transfer of title from the developer to the local governmental unit.[218] Ordinarily, acceptance is accomplished by ordinance, but it also may result from the municipality's exercise of dominion and control over the improvements.[219] State law may require the municipality to accept each part of the improvements as they are completed.[220] Certainly it is likely that if the improvements are unrelated or easily separable, the municipality will be unable to refuse a requested partial acceptance.[221]

The significance of the acceptance of dedication is that it results in the transfer of ownership of the improvements. After the date of acceptance, the burden of maintaining and repairing the improvements falls upon the municipality.

C. *The Securing Process*

One of the most significant areas in which the local government can exercise flexibility in the subdivision development process is in securing

215. *See infra* notes 274-77 and accompanying text.

216. *E.g.*, Home Builders League of S. Jersey, Inc. v. Township of Evesham, 182 N.J. Super. 357, 360, 440 A.2d 1361, 1363 (App. Div. 1981).

217. *E.g.*, Mertz v. Lakatos, 33 Pa. Commw. 230, 236, 381 A.2d 497, 500 (1978).

218. The municipality must exercise a second type of "inspection" right to ensure that it is receiving clear title to all dedicated improvements. *See* B. ROGAL, *supra* note 12, at 11.

219. Home Builders League of S. Jersey, Inc. v. Township of Evesham, 182 N.J. Super. 357, 360, 440 A.2d 1361, 1363 (App. Div. 1981).

220. *See, e.g.*, County of Kern v. Edgemont Dev. Corp., 222 Cal. App. 2d 874, 877, 35 Cal. Rptr. 629, 631 (1963) (specifying four requirements for partial acceptance).

221. *See id.* (arbitrary refusal of request for partial acceptance may be improper).

the completion of subdivision improvements. Although most state enabling acts permit the use of a variety of security devices, little is known about how, why, or under what circumstances the various devices are chosen to secure improvements in specific developments. Nevertheless, each form of security presents its own particular set of advantages and disadvantages that the local government should consider in light of the overall purposes of subdivision regulation.

1. Surety Bond

The corporate surety bond undoubtedly is the most widely permitted security device under existing law for assuring the completion of required subdivision improvements.[222] On its face, the bond is a deceptively simple instrument. It usually includes a joint and several promise by the developer, as principal, and the surety company, as obligor, to pay a specified penal sum to the local government unit, as obligee.[223] The bond then provides that if the developer performs all of the obligations of his underlying agreement with the obligee,[224] the bond shall become null and void.[225]

At the outset, it is important to note that surety bonds differ from insurance in several respects.[226] Moreover, these differences may have far reaching implications with respect to the developer's ability to obtain a bond as well as to the obligee's ability to collect on the bond in the event of a default.

Unlike insurance, a surety bond is always a three-party instrument.[227] Thus, the developer is not insuring himself in case he cannot complete the specified improvements. Rather, he has paid a fee to a corporate surety in consideration for the surety's promise to guarantee the completion of the improvements for the benefit of the obligee.[228]

The determination of the amount of the fee, or premium, is a func-

222. S. SEIDEL, *supra* note 1, at 136 (1978) (citing CENTER FOR URBAN POLICY RESEARCH, SURVEY OF MUNICIPALITIES (1976)).

223. Gorton, *Surety Bonds*, in HANDBOOK OF CONSTRUCTION MANAGEMENT AND ORGANIZATION 86 (J. Frein ed. 1980).

224. The developer's agreement with the municipality to complete required improvements is included in the bond either by express reference or by implication.

225. Gorton, *supra* note 223, at 86.

226. W. CONNERS, CALIFORNIA SURETY AND FIDELITY BOND PRACTICE § 1.4 (1969).

227. *Id.*

228. Gorton, *supra* note 223, at 83.

tion of another important difference between insurance and suretyship. An insurance company underwrites many thousands of policies. It knows to a statistical certainty that it will be called upon to pay off on a certain percentage of these policies, and it, therefore, can spread its risk of loss over its entire portfolio. Accordingly, the premium charged for insurance tends to reflect the average risk of loss rather than the specific risk associated with the single insured.[229]

In contrast, the surety underwrites relatively few bonds. To the extent possible, and consistent with business realities, he hopes that he never will be called upon to pay any claims against his bonds.[230] Thus, the surety must assure himself that the developer has both the technical and the financial capacity to perform his obligations to the local governmental unit.[231] Accordingly, the bond premium is a function of the risk of loss with respect to each individual developer and each particular project.[232]

Before he can even begin to determine the amount of the premium, the surety first must qualify the developer.[233] The qualifying process entails a two-part analysis similar to what a lender makes before approving a loan. The first part includes an assessment of the developer's financial condition, focusing primarily on his net quick worth.[234] The second part of the analysis attempts to judge the developer's experience or track record in the industry.[235] The surety will undertake to guarantee performance only if he is satisfied with respect to both parts of the qualifying procedure. Because of heavy losses sustained in the recent past, corporate sureties increasingly have become reluctant to underwrite bonds guaranteeing subdivision improvements. As a result, only the largest, most credit-worthy developers can obtain surety bonds.[236]

Assuming that the surety is willing to bond a particular project, he

229. W. CONNERS, *supra* note 226, § 1.4.

230. *See id.*

231. *See* Gorton, *supra* note 223, at 83, 87.

232. *See id.* at 83, 91; W. CONNERS, *supra* note 226, § 1.4.

233. Gorton, *supra* note 223, at 87.

234. In simple terms, net quick worth is the difference between the developer's assets that are immediately convertible to cash and his liabilities that are due within one year. For a more detailed explanation of net quick worth, see *id.* at 89-90.

235. *Id.* at 87.

236. R. HARRIS, *supra* note 4, at 2-15; M. MADISON & J. DWYER, *supra* note 72, at ¶ 9.11; B. ROGAL, *supra* note 12, at 1, 3 (1974); S. SEIDEL, *supra* note 1, at 135.

may demand a variety of other inducements in addition to his premium. These inducements usually take the form of collateral and promises by various individuals, companies, and lenders to indemnify the surety in the event that he is required to pay on the bond. It is virtually, universally required that the developer himself indemnify the surety.[237] If the developer is a partnership or corporation, all general partners or major shareholders and their spouses also may be required to indemnify the surety.[238] In addition, the development lender occasionally may be asked either to lend the collateral funds or to issue its letter of credit securing the bonding company.[239]

As one may expect, the surety bond, when available at all, may be prohibitively expensive. Even when the cost is within acceptable limits, the bond imposes an inordinately heavy cost burden on the project,[240] especially when the lender is asked to lend additional funds or to provide a letter of credit for the benefit of the surety. The additional security will result in higher costs to the developer, which he must pay in addition to the bond premium.[241] When the lender is willing to extend the additional security, it legitimately may be asked why that security cannot be directed to the benefit of the local governmental unit rather than to the surety, thus eliminating the bond and saving the cost of the premium.[242]

In the event of the developer's default, the municipality will call upon the surety to perform his obligation under the bond. Depending upon the language of the bond, the surety might have a number of

237. *See* Gorton, *supra* note 223, at 90.

238. *Id.*

239. R. HARRIS, *supra* note 4, at 2-15.

240. *See* B. ROGAL, *supra* note 12, at 6. When the developer can obtain surety bonds only at an exorbitant cost, the municipality's insistence upon their use may effectively eliminate the small developer from the development process. *Id.* at 3. *See also* Gorton, *supra* note 223, at 84 (surety companies to assume the burden of weeding out unworthy and irresponsible bidders). In a broader sense, the cost of the surety bond constitutes part of the overall cost of subdivision regulation. While the municipality has an obvious interest in securing the completion of quality subdivision improvements, the added cost of regulation, nevertheless, may have the effect of excluding those in low to moderate income brackets from the housing market. *See* S. SEIDEL, *supra* note 1, at 125. Some commentators, however, argue that strict bonding requirements should be used as a direct tool to upgrade the quality of land planning and development. McPherson, *supra* note 32, at 476-77; Yearwood, *Performance Bonding for Subdivision Improvements*, 46 J. URB. L. 67, 68 (1968).

241. R. HARRIS, *supra* note 4, at 2-15.

242. *Id.*; S. SEIDEL, *supra* note 1, at 135.

options.[243] If the project is close to completion, the surety might advance necessary funds directly to the defaulting developer.[244] Sureties rarely invoke this option because the funds advanced do not directly reduce the stated bond amount or the surety's potential liability on the bond.[245] Nevertheless, this may reduce the surety's ultimate liability to the extent that the developer actually uses the funds to complete the required improvements. Thus, when the surety has had a long-standing relationship with the developer and the default is not the result of bad faith,[246] the surety may find it in his best interest to finance the defaulting developer.[247]

As a second option, the surety either may hire another contractor or permit the defaulting developer to hire another contractor to complete the work.[248] This option has the advantage of permitting the surety to maintain direct control over the project and, in addition, places the work in the hands of a new contractor that is in a stronger financial condition and that may be bonded as well. Thus, while hiring a new contractor often results in some loss to the surety, the risk of a substantial or total loss is spread to at least two additional parties—the new contractor and his surety.[249]

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243. In general, suretyship contracts should be construed according to ordinary contract principles rather than construed strictly against the surety as in the case of an insurance contract. W. CONNERS, *supra* note 226, § 1.5.

244. *Id.* § 12.8.

245. *Id.* § 12.9; Gorton, *supra* note 223, at 91.

246. Although some defaults result from theft or diversion of progress payments, the major factors that contribute to developer failures are cost overruns, unanticipated delays attributable to poor weather conditions, labor or material shortages, and poor sales. *See* Gorton, *supra* note 223, at 85. *See also* R. HARRIS, *supra* note 4, at 6-5 to 6-7 (discussing signs indicating impending default).

247. Financing the defaulting developer may be favorable to the surety if the default is the result of a temporary problem, the project is nearly complete, the developer probably can work through the situation, and penalties may be saved. W. CONNORS, *supra* note 226, § 12.10.

248. *Id.* § 12.6.

249. The loss-spreading benefit of hiring a new contractor to complete required improvements depends, of course, on the surety's success in finding a bonded contractor that is willing to assume all of the outstanding obligations. *Id.* With respect to the municipality that is the obligee, however, the surety loses his position as surety when he undertakes to complete improvements. *Id.* The municipality will hold the surety liable for all of the principal's obligations without regard to the face amount of the bond. *Id.* Thus, before undertaking the completion of any job, the surety always must attempt to reach an agreement with the municipality concerning the exact nature and extent of the defaulting principal's outstanding obligations. *See id.*

Both of the surety's options detailed above suffer from one common and significant deficiency. If the surety chooses to undertake the actual completion of the improvements, either by financing the developer or by hiring a new contractor, he risks becoming liable as a principal for completion of the required improvements. Thus, the municipality may hold the surety to full performance of the defaulted developer's outstanding obligations without regard to the penal sum of the bond.[250]

To eliminate the potential risk of liability beyond the face amount of the bond, the surety may attempt to induce the local governmental unit to complete the improvements for a fixed amount by way of a settlement agreement.[251] Under such an agreement, the municipality and the surety estimate the amount necessary to complete the improvements, and the surety pays that amount in exchange for a release of all further liability.[252] While the settlement agreement also may release the developer, especially when it is intended to do so and when the developer knows of and consents to the settlement negotiations,[253] the surety must be careful to avoid releasing any of the developer's rights or defenses. Unless the surety clearly establishes liability, the surety will not be entitled to reimbursement from the developer under the indemnity agreement.[254]

Primarily because of the substantial risk of excess liability that may

250. Caron v. Andrew, 133 Cal. App. 2d 402, 410-11, 284 P.2d 544, 549-50 (1955) (surety remained responsible for performance of its assumed obligation when the surety assumed contractor's obligations); Copeland Sand & Gravel v. Insurance Co. of N. Am., 40 Or. App. 832, 836, 596 P.2d 623, 625 (1979) (surety liable for damages flowing from its breach where it under took to complete the princpal's obligations), *rev'd*, 288 Or. 325, 607 P.2d 718 (1980).

251. *See* W. CONNERS, *supra* note 226, § 12.7. Ordinarily, the municipality uses the settlement funds to hire its own contractor to complete the improvements. *See id.* In some circumstances, however, the municipality may be able to utilize its own maintenance or construction crews.

252. *See* M. Zerman Realty & Bldg. Corp. v. Borough of Westwood, 64 N.J. 590, 591-92, 319 A.2d 441, 441-42 (1974).

253. *See id.* In *M. Zerman Realty*, the surety entered into a settlement agreement with the borough with the knowledge and consent of the principal. Later, the principal sought to avoid his own discharge in order to attempt to recover a portion of the amount paid by the surety that allegedly was in excess of the amount necessary to complete the improvements. *Id.* at 591, 319 A.2d at 442.

254. The surety need not submit to suit in all cases in order to protect his right to reimbursement by the principal. When the surety makes payment without submitting to suit, however, the courts will allow reimbursement only when the surety clearly can establish liability and prove that the suit would have been a mere formality. Ragghianti v. Sherwin, 196 Cal. App. 2d 345, 351, 16 Cal. Rptr. 583, 587 (1961).

result if the surety undertakes to complete the improvements for the defaulting developer, sureties, in most instances, will elect to rest on the bond and prepare to pay damages up to the stated amount.[255] Unfortunately, this election generates a tremendous amount of litigation.[256]

The local governmental unit generally will succeed in its suit against the surety if it can establish five elements: 1) it had authority to exact improvements from the developer;[257] 2) the developer agreed to complete the improvements;[258] 3) the local government had authority to require the developer to secure a bond;[259] 4) the developer failed to

255. W. CONNERS, *supra* note 226, § 3.8. Although denoted as a penalty, courts ordinarily hold that the face amount of the bond is the limit of the surety's liability rather than a forfeiture amount. *Id.* § 2.3. *See, e.g.*, Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 36, 245 S.E.2d 425, 430 (1978) (nothing in the bond, statute, or ordinance indicated an intent to create a forfeiture bond). *See also* City of Rye v. Public Serv. Mut. Ins. Co., 34 N.Y.2d 470, 473, 315 N.E.2d 458, 459, 358 N.Y.S.2d 391, 393 (1974) (without statutory authority, agreement providing for forfeiture is unenforceable).

256. In addition to protecting his right of reimbursement, *see supra* note 254, the surety also will be inclined to litigate the issue of damages. *See* General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, 759 (Colo. 1981).

257. *E.g.*, Bella Vista Ranches, Inc. v. City of Sierra Vista, 126 Ariz. 142, 143, 613 P.2d 302, 303 (Ariz. App. 1980) (city lacked authority to regulate subdivisions in absence of an enabling statute); Anderson v. Pima County, 27 Ariz. App. 786, 788, 558 P.2d 981, 983 (1976) (in absence of an enabling statute, county lacked authority to require security for completion of improvements); Wood Bros. Homes v. City of Colorado Springs, 193 Colo. 543, 547-48, 568 P.2d 487, 490-91 (1977) (requirement that the developer bear the entire cost of an off-site improvement exceeded the authority granted by ordinance); Hylton Enters. v. Board of Supervisors, 220 Va. 435, 441, 258 S.E.2d 577, 581 (1979) (neither statute nor ordinance granted the county express or implied authority to require improvements to public highways abutting subdivision).

258. *E.g.*, Fireman's Fund Indem. Co. v. County of Sacramento, 179 Cal. App. 2d 319, 322, 3 Cal. Rptr. 607, 608 (1960) (county's acceptance of subdivision map and bond created a contract to complete improvements required by statute); Indian River County v. Vero Beach Dev. Inc., 201 So. 2d 922, 924 (Fla. Dist. Ct. App. 1967) (agreement to make improvements includes implied agreement to comply with specifications required in subdivision regulations); Township of Hampden v. Tenny, 32 Pa. Commw. 301, 307-08, 379 A.2d 635, 638 (1977) (agreement to include improvements as a condition of subdivision approval implies agreement to complete improvements or to reimburse township for costs of completion).

259. *E.g.*, Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 795, 567 P.2d 642, 647 (1977) (authority to require completion bond necessarily implied from statutory powers expressly granted to county). *See* Genesee County Bd. of Road Comm'rs v. North Am. Dev. Co., 369 Mich. 229, 235-36, 119 N.W.2d 593, 597 (1963) (when developer voluntarily agreed to make nonrequired off-site improvements in exchange for the Board's assurances to the FHA, the bond securing the developer's performance was enforceable on contract theory). *But see* Anderson v. Pima County, 27 Ariz. App. 786,

complete the improvements;[260] and 5) the local government consequently was damaged in a reasonably ascertainable amount.[261]

The surety may escape all or part of its liability by successfully attacking any one of the five essential elements. In addition, the surety may interpose a number of defenses, either directly or on behalf of the developer. The various defenses that sureties assert include, among others: 1) the cause of action has not yet accrued;[262] 2) the limitation period has expired;[263] 3) the government's action is barred for want of prosecution;[264] 4) the surety is discharged because of modification of the underlying agreement;[265] 5) the local government fails to perform a

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788, 558 P.2d 981, 983 (1976) (county lacked authority to require bonds or other security in absence of an enabling act).

260. Generally, completion includes the municipality's approval and acceptance of dedication. When no building activity has begun, however, the courts may bar the municipality from collecting on the bond. Town of New Windsor v. Inbro Dev. Corp., 112 Misc. 2d 983, 984, 448 N.Y.S.2d 99, 100 (N.Y. Sup. Ct. 1982); *cf.* County of Yuba v. Central Valley Nat'l Bank, 20 Cal. App. 3d 109, 112, 97 Cal. Rptr. 369, 371-72 (1971) (recovery on letter of credit barred when the developer commenced no activity). *But cf.* Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 38 (Colo. 1981) (court permitted recovery on letter of credit even though the developer commenced no activity).

261. When the purpose of the bond is to secure completion of required improvements, the usual measure of damages is the cost of completion. General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, 758-59 (Colo. 1981); Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 36-37, 245 S.E. 2d 425, 429-30 (1978); Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 796, 567 P.2d 642, 648-49 (1977).

262. *See* City of Norman v. Liddell, 596 P.2d 879 (Okla. 1979). In *Liddell*, the ordinance required the city to initiate a suit to recover for non-completion "prior to the expiration of the bond." *Id.* at 881. The developer had agreed to complete all improvements within two years, and the bond's expiration date was the last day of the two year period. The court held, however, that the developer would not have been in breach prior to the expiration of the full two year period, and, therefore, the cause of action could not arise until that time had elapsed. *Id. See also* Sherwood Forest No. 2 Corp. v. City of Norman, 632 P.2d 368, 369-70 (Okla. 1980) (construing same ordinance). *But see* Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 34, 245 S.E.2d 425, 428 (1978) (county permitted to maintain action prior to the completion date when evidence indicated that the developer had abandoned the contract).

263. *E.g.*, City of New Orleans v. Mark C. Smith and Sons, Inc., 339 So. 2d 321, 322 (La. 1976) (applying a five year limitation period for actions on contract rather than the shorter limitation period pertaining to "public works" contracts).

264. *E.g.*, City of Los Angeles v. Gleneagle Dev. Co., 62 Cal. App. 3d 543, 564, 133 Cal. Rptr. 212, 225 (1976) (dismissing an action against the surety for want of prosecution).

265. *E.g.*, Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 800, 567 P.2d 642, 649-50 (1977) (modification of specifications and extension of time for performance did not discharge surety when the bond secured completion "to the satisfaction of the

condition precedent to the surety's obligation;[266] 6) the government has accepted the improvements, either expressly,[267] impliedly,[268] or by operation of law;[269] and 7) the bond payment provision constitutes an unenforceable penalty.[270]

Use of the corporate surety bond to secure the completion of required subdivision improvements undoubtedly provides many advantages over the two historic alternatives of either requiring no security at all or requiring that the developer complete the improvements before he can transfer title to any lots. Its functional utility, however, may not be as great as once was thought. To the developer, it represents an onerous and arguably unnecessary cost; to the lot or homebuyer, it results in an additional cost that must be financed and eventually paid for; and to the local governmental unit, it may provide nothing more than an illusory sense of security and a real source of litigation. Fortunately, various other security devices are available that may, to some extent, offset or minimize the disadvantages of the surety bond.

2. Cash Escrow

In its simplest form, the cash escrow consists of the developer's de-

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County Road Engineer," within a specified time unless "extended at the option of the County Road Engineer").

266. *E.g.*, City of Medford v. Fellsmere Realty Co., 345 Mass. 477, 480-81, 187 N.E.2d 849, 852 (1963) (surety not liable when the city failed to perform condition precedent to the developer's obligation).

267. *See* County of Kern v. Edgemont Dev. Corp., 222 Cal. App. 2d 874, 877, 35 Cal. Rptr. 629, 631 (1963) (developer obligated to maintain improvements after completion, inspection, and approval by the county when the developer failed to apply for partial acceptance).

268. *E.g.*, Anne Arundel County v. Lichtenberg, 263 Md. 398, 407, 283 A.2d 782, 787 (1971) (county's recordation of deeds does not waive the requirement of formal written acceptance); Home Builders League of S. Jersey, Inc. v. Township of Evesham, 182 N.J. Super. 357, 360, 440 A.2d 1361, 1363 (App. Div. 1981) (township's release of bond was not an exercise of dominion and control resulting in acceptance of dedication).

269. *Compare* Mertz v. Lakatos, 33 Pa. Commw. 230, 236, 381 A.2d 497, 500 (1978) (township's failure to approve or disapprove within the statutory period resulted in deemed approval and release of liability) *with* Township of Barnegat v. DCA of N.J., Inc., 181 N.J. Super. 394, 400-03, 437 A.2d 909, 912 (App. Div. 1981) (when the township failed to approve or disapprove within the statutory period, deemed approval would not result unless improvements were in fact substantially complete at the time of notice of completion).

270. City of Rye v. Public Serv. Mut. Ins. Co., 34 N.Y.2d 470, 472-73, 315 N.E.2d 458, 459, 358 N.Y.S.2d 391, 393 (1974).

posit with an escrow agent of a specified sum of money, usually the estimated cost of the required improvements. If the improvements are completed by the developer and accepted by the government, the agent releases the escrowed funds to the developer. If, however, the developer fails to complete the improvements as required, the agent releases the funds to the government.[271] Obviously, the simple cash escrow may be every bit as onerous to the developer as if he were required to construct all of the improvements in advance of any sales.[272] Thus, when the government requires the developer to keep the full amount on deposit until he has completed all of the improvements, the result is that that portion of the project must be double-funded because the work still must be paid for as it progresses.[273] Accordingly, the parties have adopted various adaptations in an attempt to alleviate some of the more burdensome aspects of cash escrows.

The first variation consists of periodic releases of portions of the escrowed funds as the project progresses.[274] While the periodic release of funds mitigates the double-funding problem to an extent, it fails to eliminate the problem altogether. Before the local government releases any funds, the government must assure itself that the developer has completed a portion of the improvements and that the developer has paid all parties and removed all liens. Thus, the project will be double-funded at least in an amount equal to the amount of each release.[275] Nevertheless, provided that the government acts with all due dispatch in inspecting, approving, and accepting completed improvements, and in ordering the release of funds, the amount of the double-funding may be limited.[276]

The government also must take care that it does not permit the release of too great a portion of the escrowed funds. This is particularly important when the total deposit is less than the value of all of the improvements, when the cost of labor and material is escalating rapidly, or when the value of the improvements is underestimated at the outset. In the event of the developer's default, the government may

271. B. ROGAL, *supra* note 12, at 6-7.

272. *See* S. SEIDEL, *supra* note 1, at 135.

273. R. HARRIS, *supra* note 4, at 2-18.

274. *See id.*; S. SEIDEL, *supra* note 1, at 135.

275. R. HARRIS, *supra* note 4, at 2-18.

276. *See* S. SEIDEL, *supra* note 1, at 136. The results of one survey indicate that most municipalities release bonds or escrowed funds within 65 days of completion. *Id.* at 156 n.32.

find itself with an escrow fund that is insufficient to cover the cost of completing the required improvements.[277]

A second variation on the cash escrow theme arises from a recognition that the cash deposited ordinarily constitutes part of the proceeds of the development loan.[278] Accordingly, the lender itself may be induced to segregate or set aside funds from the loan proceeds in an amount sufficient to complete the required improvements.[279] In this situation, the lender will issue a set-aside letter to the municipality agreeing to segregate funds and to disburse these funds only after the developer has completed the improvements, and the government has approved and accepted them.[280]

The lender must make certain that the set-aside funds actually are held in reserve to ensure that these funds are available in case of default,[281] but to the extent that these funds are retained, the set-aside will result in the same double-funding problem present in the ordinary cash escrow.[282] The lender also must take care that it does not release set-aside funds to the developer prior to the government's approval of the release. The lender's premature release of funds may result in the lender's liability to the government in the event of the developer's default.[283]

Irrespective of the deficiencies of the set-aside method of securing the completion of required improvements, this method actually may be structured to the lender's advantage. The lender has a substantial stake in the success of the overall project. Not only will the lender look to the developer for repayment of the loan from the sales proceeds, but

277. If the escrow fund proves insufficient to cover the cost of completion, the municipality may not be able to withhold building permits or certificates of occupancy in an attempt to force completion. *Cf.* Key Fed. Sav. & Loan Ass'n v. Anne Arundel County, 54 Md. App. 633, 641, 460 A.2d 86, 91-92 (1983) (when the county exacted completion bond as condition of plat approval, it could not subsequently withhold building permits or occupancy certificates pending completion); Incorporated Village of Northport v. Guardian Fed. Sav. & Loan Ass'n, 87 Misc. 2d 344, 347, 384 N.Y.S.2d 923, 926 (N.Y. Sup. Ct. 1976) (village could not withhold a certificate of occupancy after accepting a bond as security for completion of the required improvements).

278. *See* R. HARRIS, *supra* note 4, at 2-18.

279. M. MADISON & J. DWYER, *supra* note 72, § 9-11.

280. *Id.*

281. *Id.* § 9-12.

282. *See supra* notes 273-76 and accompanying text.

283. The loan documents should specify that any funds subsequently paid to the municipality because of a shortage in the set-aside fund will be added to the developer's original loan amount. M. MADISON & J. DWYER, *supra* note 72, § 9-12.

also the lender must count on its security interest in the lots in the event of default. To the extent that the developer has completed the required improvements, the value of the lots will increase. Consequently, it is to the lender's advantage to ensure that the developer completes the improvements. The set-aside fund offers the lender control over the completion of the improvements. Thus, regardless of the government's inspection and approval process, the lender also may inspect and approve construction prior to disbursement of set-aside funds.[284]

Additionally, the lender may require that the government inspect completed improvements and approve or disapprove the release of set-aside funds within a reasonable time after the developer's request.[285] This tends to increase cash flow to the project and minimizes the double-funding overlap problem.[286]

Finally, the lender may retain the option to complete the required improvements if the developer defaults.[287] Although this can entail the expenditure of funds in excess of the set-aside amount, it may be justified as an effort to enhance the value and marketability of the collateral.

3. Property Escrow

The property escrow is structured in much the same way as a cash escrow. If the developer defaults, the local government gains access to the property and can sell the land to raise the funds necessary to complete the required improvements. Among the various types of property that the government can escrow are stocks and bonds, personal property such as the developer's equipment, and the developer's real property.

The first difficulty with the property escrow is determining the value of the property.[288] Because the developer usually must escrow property in an amount sufficient to meet the estimated cost of the improve-

284. *See id.* at app. B-206, form 9.2.

285. *Id.* § 9-11. State statutes also may require approval within a specific time. *See* Township of Barnegat v. DCA of N.J., Inc., 181 N.J. Super. 394, 397, 437 A.2d 909, 910 (App. Div. 1981); Mertz v. Lakotos, 33 Pa. Commw. 230, 233-34, 381 A.2d 497, 499-500 (1978).

286. *See* R. HARRIS, *supra* note 4, at 2-18.

287. M. MADISON & J. DWYER, *supra* note 72, § 9-11.

288. B. ROGAL, *supra* note 12, at 7.

ments,[289] the property must be appraised with care. When stocks or bonds are escrowed, the initial valuation may be relatively simple. Stocks and bonds, however, frequently fluctuate in value and are prone to wide swings in market price.[290]

Determining the realistic value of the developer's equipment can be extremely difficult. The equipment is likely to have been used prior to the development; therefore its aggregate value will depend upon the condition of each piece. Moreover, the developer almost certainly will use the equipment during the course of the development. Thus, even if its value is readily ascertainable at the outset, there is no guarantee that the equipment will have any value at the time of default.

Real property also presents genuine valuation problems, especially if the land is undeveloped. Land is susceptible to wide fluctuations in value caused by factors beyond the control of either the developer or the local government. Moreover, the value of a particular parcel of land will be attributable, in part, to the very fact that that developer owns it. In other words, the mere expectation of development of the developer's other land in the immediate vicinity bolsters the value of a particular parcel. Clearly, some of the inflated value will evaporate if the developer defaults on his present development.

The second major problem with the property escrow derives from the relative lack of the escrowed property's marketability. The purpose of requiring security for the developer's promise to complete the required improvements is to ensure that the developer, in fact, will construct the improvements at no cost to the government. Thus, if the developer defaults, the government must sell the property to raise the funds necessary to complete the improvements.[291] After the developer's default, the local government may be faced with two equally unattractive alternatives: it either may prepare to expend substantial

289. *See supra* notes 204-06 and accompanying text.

290. In one recent survey, approximately 9% of the responding municipalities indicated that the property escrow was an acceptable form of security. S. SEIDEL, *supra* note 1, at 136 (citing CENTER FOR URBAN POLICY RESEARCH, SURVEY OF MUNICIPALITIES (1976)). Apparently, the acceptance of stocks and bonds by these municipalities for use in the property escrow is fairly common. B. ROGAL, *supra* note 12, at 7. The potentially wide fluctuations in value of most marketable securities, however, tend to make them unsuitable as an effective source of sufficient funds to enable the municipality to complete improvements upon the developer's default. S. SEIDEL, *supra* note 1, at 135.

291. *See* B. ROGAL, *supra* note 12, at 7-8.

time and effort in order to sell the property at or near its appraised value, or it may sell the property quickly, sometimes at a sacrifice.

Valuation and marketability represent the first tier of problems encountered in any property escrow. A second level of problems also will be evident with a relatively small or undercapitalized developer.[292] The typical small or medium-size developer probably will not own a sufficient amount of property to satisfy the requirements of a property escrow. In fact, most of the developer's property will consist of the land that he proposes to develop. This land, however, is apt to be subject to prior liens in favor of the original seller, the development lender, or both. Moreover, because the developer usually is highly leveraged, his equity position will be minimal. Thus, in order for the government to be adequately secured, the senior lienors must subordinate their liens for the local government to be able to obtain the property free of encumbrances upon the developer's default.[293]

When the lender subordinates its lien on the subdivison property to the government's claim, the lender's security is accordingly diminished. Consequently, the lender will require periodic releases of portions of the property as the developer installs the required improvements.[294] Like any partial release of security, cost efficiency demands the prompt release of the security. When the subdivision property is involved, however, the local government must consider a number of factors in addition to the mere determination that the developer has completed a portion of the improvements.

In order for the subdivision project to be successful, the developer must sell lots or homes during the course of the project. The buyers, of course, will expect to take title free of prior encumbrances. Therefore, the government is subject, to a certain degree, to the whims of the marketplace in its choice of which lots to release. Unfortunately, the lots that the developer sells first often are in the most desirable part of the subdivision. Thus, for example, the local government may find itself, after the developer's default, holding seventy percent of the total number of lots that represent only thirty percent of the total land value.

A related problem occurs if the local government permits the haphazard release of lots scattered about the subdivision.[295] If the devel-

292. *See* S. SEIDEL, *supra* note 1, at 135.

293. R. HARRIS, *supra* note 4, at 2-19. *See* B. ROGAL, *supra* note 12, at 7.

294. *See* R. HARRIS, *supra* note 4, at 2-19 to 2-20.

295. M. MADISON & J. DWYER, *supra* note 72, § 9-5.

oper defaults after he has sold a substantial number of lots, the government may be left with a number of individual lots rather than with one or a few larger parcels. Unless the government can locate a buyer that is willing to purchase all of the lots, they will have to be sold on a piecemeal basis, possibly resulting in increased delays and costs to the government. Furthermore, even if the government can locate a single buyer, the overall price probably will be lower than the price of contiguous lots.

4. Letter of Credit

The letter of credit provides a direct means by which the development lender can support the developer's promise to complete required subdivision improvements. Initially, letters of credit were devised to facilitate the sale of goods in international commerce.[296] In recent years, however, "standby" or "guarantee" letters of credit have been used to secure or guarantee a bank customer's performance of contractual obligations to a third party.[297]

Basically, three separate and distinct contractual relationships exist in any letter of credit transaction.[298] First, an underlying agreement exists—for example, between the developer and the government. Second, the bank's customer, the developer, and the issuer of the letter of credit, the bank, enter into an agreement.[299] Finally, the letter of credit creates an agreement between the issuer, the bank, and the beneficiary, the local government.[300]

The fundamental distinction between a letter of credit and other types of security devices is that the letter of credit imposes an obligation on the issuer to honor a demand for payment that is completely independent of the underlying agreement between the customer and the beneficiary.[301] Thus, the bank may not dishonor a letter of credit even if it knows that the developer never began construction and that

296. Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 BANKING L.J. 816, 816 (1977).

297. Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36 (Colo. 1981).

298. *Id.*

299. *See* U.C.C. § 5-103, 2A U.L.A. 229-30 (1977).

300. Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36 (Colo. 1981). *But see* Joseph, *supra* note 296, at 850 (relationship between insurer and beneficiary not strictly contractual).

301. *See* U.C.C. § 5-114(1), 2A U.L.A. 259 (1977); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36 (Colo. 1981).

the local government, therefore, suffered no damage, or that the government did not intend to use the proceeds from the letter of credit to complete the required improvements.[302]

Because of the independent nature of the bank's obligation on a letter of credit, it is vitally important that any conditions that the develops or lender seeks to attach to collection or use of the funds be included in the terms of the letter of credit.[303] Often banks will issue letters of credit conditioned only upon a statement by a proper local official that the developer has not completed improvements in compliance with the developer's agreement with the local government.[304] Upon the production of the letter of credit and the required notice, the bank has no alternative but to pay the draft.[305] In other words, the lender, by making the initial development loan, has signified its faith in the developer's ability to perform all of his contractual obligations. Thus, there may be a tendency for the lender to be lulled to sleep.

Therefore, the lender clearly must take steps to protect himself in the event of a default. First, the lender should add the amount of credit issued to the amount of the development loan for the purpose of determining the developer's financial qualifications.[306] Second, the loan document should specify that if any funds are drawn against the credit, the lender will add that amount to the development loan balance and

302. Proof of damage on an obligation to complete required improvements should be included as a condition of the letter of credit. *See* R. HARRIS, *supra* note 4, at 2-24 to 2-25; U.C.C. § 5-114(2), 2A U.L.A. 259 (1977); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 38 (Colo. 1981). Generally, however, the lender and developer expressly must include such conditions in the credit document itself. *Compare id.* at 38-39 (terms of underlying agreement irrelevant to issuer's liability) *with* County of Yuba v. Central Valley Nat'l Bank, 20 Cal. App. 3d 109, 113, 97 Cal. Rptr. 369, 372 (1971) (purpose of the underlying agreement incorporated by implication into credit document).

303. *See* R. HARRIS, *supra* note 4, at 2-25 to 2-26, form 2.4.

304. *E.g.*, Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 38 (Colo. 1981).

305. The Uniform Commercial Code provides: "(1) An issurer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary." U.C.C.§ 5-114(1), 2A U.L.A. 259 (1977). The issuer, however, may "defer honor until the close of the third banking day following receipt of the documents." *Id.* § 5-112(1)(a), 2A U.L.A. at 253.

306. *See* Verkuil, *Bank Solvency and Guaranty, Letters of Credit*, 25 STAN. L. REV. 716, 723 (1973). *See also* Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251, 258 (1972).

the same collateral will secure the funds drawn against the credit.[307] Third, the lender should condition the letter of credit upon proof of actual damage to the local government[308] and upon the government's promise to apply the funds to the completion of the improvements.[309] Finally, the letter of credit should provide that the government should return to the lender all funds that the government draws against the credit, but fails to expend.[310]

Obviously, as the lender attempts to impose conditions upon payment of the letter of credit, the local government will, or should, become less inclined to accept it as security for the completion of required improvements. The tension created by the apparently conflicting needs of the parties stems from the fact that the letter of credit is fundamentally a payment device. Nonetheless, both the lender and the local government have an interest in seeing that the improvements are, in fact, completed. The letter of credit, however, is ill-suited to allocating the wide-ranging responsibilities for completion.

5. Subdivision Improvement Agreement

The subdivision improvement agreement is a comprehensive three-party agreement in which the lender promises to fund a specified amount of money to the developer for the purpose of constructing required improvements, the developer promises to use these funds to complete the improvements, and the local government promises to accept the dedication of the completed improvements.[311] The security

307. *See* R. HARRIS, *supra* note 4, at 2-22. Although the issuer is entitled to immediate reimbursement of any payment made under the credit, U.C.C. § 5-114(3), 2A U.L.A. 259 (1977), it is unlikely that the defaulting developer will be able to repay the issuer.

308. *See* R. HARRIS, *supra* note 4, at 2-24. *See also* County of Yuba v. Central Valley Nat'l Bank, 20 Cal. App. 3d 109, 113-14, 97 Cal. Rptr. 369, 372 (1971) (recovery denied when the county suffered no damage).

309. *See* R. HARRIS, *supra* note 4, at 2-25. A condition obligating the municipality to use the letter of credit proceeds to complete the improvements is especially important to the issuer because completion will enhance the value of the collateral. *Id.* Without an express condition to this effect, however, it may prove difficult for the lender to compel the municipality to complete the improvements. *See* Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 39 (Colo. 1981).

310. *See* R. HARRIS, *supra* note 4, at 2-26, form 2.4. The requirement for the return of unused funds is a method of limiting the local governmental unit's recovery to its actual damage when the amount necessary to complete the improvements cannot be determined accurately prior to completion.

311. *Id.* at 2-27 to 2-31, form 2.5.

aspect of the agreement arises from the lender's direct promise to the government to continue funding the improvement portion of the loan even after the developer defaults.[312] In essence, the subdivision improvement agreement is an attempt to incorporate the benefits and eliminate the burdens of the various other security methods. There are seven potential benefits of this type of agreement: 1) the removal of surety bond barriers to smaller developers; 2) the savings of bond premiums; 3) the elimination of suretyship defenses; 4) the elimination of the inflexibility of the letter of credit; 5) the increase of control over security funds by a party with an economic interest in completing the improvements; 6) the decrease in the likelihood of litigation; and 7) the probability that the developer or lender actually will construct the subdivision improvements.[313]

The major barrier to the successful use of the subdivision improvement agreement arises from the fact that few, if any, statutes or ordinances expressly provide for acceptance of this type of security. Although the agreement cannot be termed a bond, escrow deposit, or letter of credit, those jurisdictions governed by statutes or ordinances that permit the use of "other forms of security" may sanction its use.[314] Even in these jurisdictions, however, it remains to be seen whether officials of a particular local government have the requisite "administrative flexibility" to accept such an agreement.[315]

A well-drafted subdivision improvement agreement should provide that, upon the developer's default, the lender will disburse no further funds to or at the direction of the developer. The lender then should retain the option to cure the default by completing the improvements itself. If the lender elects not to complete the improvements, it may disburse funds directly to the local government as required. It is, of course, necessary that the government actually apply the funds released to it to improvement construction. For the lender's protection, the agreement also should provide that all funds that the lender expends or disburses to the government shall constitute advances made under the initial loan instrument in order for the developer's collateral to secure the advances made.[316]

312. *Id.* at 2-26. This obligation may be limited to the loan amount originally budgeted for municipally-required improvements or the undisbursed portion of that amount.

313. *Id.*

314. *See supra* note 198 and accompanying text.

315. R. HARRIS, *supra* note 4, at 2-27.

316. *See generally id.* at 2-27 to 2-31, form 2.5.

The primary advantage to the lender of this form of agreement is that the lender retains the right to control the expenditure of improvement funds in the event of the developer's default.[317] This control element is especially important because the lender has a financial stake in the subdivision lots, which constitute collateral for the development loan. Thus, each dollar spent by the lender in improving these lots has a direct effect on the value and ultimate marketability of the lots.[318]

The local government appears to have an enhanced prospect of actually having the improvements completed without any significant increase in its own obligations.[319] If the lender elects to proceed with the improvement construction, the government must do no more than was previously required—that is, to inspect, approve, and accept the improvements.[320] Moreover, because the ultimate obligation rests on a direct promise from a financially interested party, the local government will less likely be forced to resort to litigation in order to secure performance.[321]

From the developer's point of view, the subdivision improvement agreement also offers a number of advantages over other security methods. First, the agreement may eliminate the delay and expense associated with qualifying for a surety bond.[322] Second, the agreement can eliminate the cost of the bond premium.[323] Third, the agreement may avoid the conflicts of attempting to satisfy the multiple collateral requirements of both the lender and the surety[324] or escrow fund.[325] Finally, and especially important for the smaller developer, the

317. *See id.* at 2-26.

318. The injection of additional funds into a project actually may not increase the net gain to the lender. For example, an expenditure of $100,000 to complete improvements might increase the market value of the land only by that amount or less. Nevertheless, it is clear that a completely improved tract of land will be more marketable than a partially improved tract.

319. Because of the lender's economic incentive, it is likely that it will exercise its option to take over the completion of the improvements. In contrast, if the local governmental unit is successful in collecting the proceeds of a surety bond, escrow account, or letter of credit, the administrative and managerial burden of completing the improvements will fall upon the local government.

320. *See* R. HARRIS, *supra* note 4, at 2-29, form 2.5.

321. Compare the lender's incentive to complete the improvements with the surety's incentive to litigate.

322. *See supra* notes 233-36 and accompanying text.

323. *See supra* notes 240-42 and accompanying text.

324. *See supra* notes 237-39 and accompanying text.

325. *See supra* notes 271-77 and accompanying text.

subdivision improvement agreement enables the developer to finance and secure the entire development package from one local lender.[326]

6. Sequential Approval

Sequential approval, or staged development, although technically not a security device, nevertheless offers a means by which a local government ostensibly can assure itself that the developer will complete the required improvements. Basically, a relatively large subdivision will be broken up into smaller sections with approval of each section conditioned upon the completion of all required improvements in the previous section.[327] Thus, the risk of nonapproval of each succeeding section theoretically provides the developer with a sufficient incentive to complete the improvements.[328]

Because no bond is required, some commentators have suggested that the sequential approval method may be ideal for the small developer.[329] It is doubtful, however, that this method will provide a useful alternative for the smallest developers. In order for the sequential approval method to work effectively, the subdivision must be sufficiently large to enable division into feasible smaller sections. It may be economically impractical, for example, to split a twenty lot subdivision into two or more sections. Development of larger subdivisions, however, requires massive infusions of borrowed capital at every stage of the project, and the prospects of the smaller developer obtaining these loans is remote. Thus, the more likely it is that the sequential approval technique will work, the more likely it is that the smaller developer will not be involved.

A potential barrier to the effective use of the sequential approval method arises from the very nature of the required improvements. When, as in years past, the required subdivision improvements were limited to the paving of streets and the installation of water and sewer lines, improvements easily could be extended on a piecemeal basis as the project progressed. At present, however, local governments require developers to install numerous and varied improvements, many of which do not lend themselves to piecemeal construction. For example,

326. *Cf.* R. HARRIS, *supra* note 4, at 4-34 (discussing advantages to the developer of total project financing).

327. *See* B. ROGAL, *supra* note 12, at 8. A municipality may require a surety bond or other type of financial security before it approves the final section. *Id.*

328. *See id.*

329. *Id.*; S. SEIDEL, *supra* note 1, at 136.

it will be risky from a security standpoint to permit the developer of a ten-stage development project to begin the second stage of improvements after completion of one-tenth of a required sewer plant. To require completion of the entire plant before approval of the second stage, however, will destroy the benefit of the sequential approval method.

A further significant deficiency of the sequential approval process is its lack of flexibility. Because approval of each stage of a development is dependent upon the prior completion of all improvements in the previous stages, each stage is necessarily a complete mini-subdivision. Thus, the method may restrict or eliminate economies of scale. Moreover, the developer will lack the flexibility to make certain tactical decisions with respect to the day-to-day progression of the project.

As may be expected, a large subdivision can take from several months to two years or more to complete. During this time, any number of events may occur that require adjustments in the building schedules: one or more types of material may be unavailable; labor strikes can affect certain trades; and soil or weather conditions can dictate that construction emphasis be moved from one portion of the subdivision to another. If these or other events require a significant modification of the construction sequence that cannot be obtained within a particular stage, the developer will be faced with two alternatives: he either may halt or slow construction in anticipation of an early resolution of the problem and accept the resultant on-going interest costs, or he may attempt to pressure the local government into approving construction in a subsequent stage of the subdivision. The latter alternative probably is the most palatable and promising to the developer. Moreover, the government may find it extremely difficult to deny a requested approval. Given a sufficiently high level of ongoing costs, the developer may face severe financial difficulty in a relatively short time. Thus, the local government unit may deem it more prudent to permit the premature approval of subsequent stages rather than face the prospect of a potential, imminent default.

The sequential approval method of assuring the completion of required subdivision improvements is advantageous to the developer because it does not impose any additional layer of costs on the development process. For this very reason, however, no independent third parties exist from whom the local government may seek financial relief.[330] Although strict adherence to sequential release tends to re-

330. B. ROGAL, *supra* note 12, at 8; S. SEIDEL, *supra* note 1, at 136.

duce the local government's exposure to risk of loss, a defaulted subdivision virtually is certain to result in at least some uninsured loss.[331]

This survey of security methods reveals the tension between the financial needs of the developer and the concern of the government for assuring quality development. Understandably, the private and public sectors of the development process do not always see eye to eye, with the result that the courts are called upon to resolve many disputes.

IV. THE LAW OF SUBDIVISION IMPROVEMENT REQUIREMENTS AND GUARANTEES

The volume of case law regarding subdivision controls and subdivision improvement requirements reflects the importance of these laws as a means for regulating subdivision development. The lack of uniformity that appears in the cases can be explained by two major factors: differences in state statutes and local ordinances, and differences in the courts' conceptions of good public policy. Part IV of this Article begins by examining the basic power of local governments to regulate subdivisions and enforce subdivision improvement requirements. This section subsequently reviews suits against the government brought by purchasers in or neighbors of the subdivision; suits brought by the government to enforce promises to complete improvements; suits by third parties that claim some right under the bond or other security agreement; defenses available to the surety and the developer; and, finally, developer remedies against the government.

A. *The Power of the Local Government to Regulate Subdivision Development*

1. The General Powers of Local Government

Local governments possess no inherent power to regulate subdivision development and lacking a state enabling statute, local regulation is void.[332] Even when enabling legislation exists, local authority is limited to the extent permitted by state law.[333] Although differences may

331. *See* B. ROGAL, *supra* note 12, at 8; S. SEIDEL, *supra* note 1, at 136.

332. *See* Bella Vista Ranches, Inc. v. City of Sierra Vista, 126 Ariz. 142, 143, 613 P.2d 302, 303 (Ariz. App. 1980); El Dorado at Santa Fe, Inc. v. Board of County Comm'rs, 89 N.M. 313, 317, 551 P.2d 1360, 1367 (1976).

333. Transamerica Title Ins. Co. v. Cochise County, 26 Ariz. App. 323, 326, 548 P.2d 416, 421 (1976) (county was without power to regulate division of land into parcels of more than 35 acres).

exist in the political nature of cities and counties,[334] both governmental units possess only such powers delegated to them by the state legislature and those that are necessarily implied.[335] In addition, when a local government attempts to regulate subdivision development, it must enact its regulations pursuant to the proper state law and in the manner prescribed by that law.[336] Thus, a local government may not enact planning regulations to accomplish zoning purposes because state enabling statutes limit the purposes for which planning regulations can be used.[337]

When state statutes prescribe a procedure by which local governments exercise their power, generally they are not free to deviate from that procedure.[338] Thus, if state law permits the local government to accept a bond in lieu of improvements, the government may not require a cash escrow.[339] Likewise, if the law requires that the developer complete improvements or tender a performance bond prior to final plat approval, the local government cannot agree with the developer that it will install the improvements and assess the costs against the lots in the subdivision.[340] Finally, if state law permits the local government to require the developer to improve and dedicate a road within the subdivision, the government cannot require the developer to reserve a right-of-way for future use as a road.[341]

A local government possesses more than express statutory power—it

334. *See id.* (a county is a mere arm of the state government while a city is a voluntary organization).

335. *See* El Dorado at Santa Fe, Inc. v. Board of County Comm'rs, 89 N.M. 313, 317, 551 P.2d 1360, 1364 (1976) (referring to counties).

336. *See* Anderson v. Pima County, 27 Ariz. App. 786, 788, 558 P.2d 981, 983 (1976) (county could not enact security methods for subdivision improvements as an interim zoning measure without strict compliance with state law); Magnolia Dev. Co. v. Coles, 10 N.J. 223, 228, 89 A.2d 664, 667 (1952) (city only could regulate subdivisions by adopting regulations according to mandate of state law, including notice and hearing).

337. Kaufman & Gold Constr. Co. v. Planning & Zoning Comm'n, 298 S.E.2d 148, 153-57 (W. Va. 1982); Singer v. Davenport, 264 S.E.2d 637, 640-42 (W. Va. 1980).

338. El Dorado at Santa Fe, Inc. v. Board of County Comm'rs, 89 N.M. 313, 318, 551 P.2d 1360, 1364 (1976).

339. LaSalle Nat'l Bank v. Village of Brookfield, 95 Ill. App. 3d 765, 769, 420 N.E.2d 819, 821-22 (1981).

340. Friends of the Pine Bush v. Planning Bd., 86 A.D.2d 246, 249, 450 N.Y.S.2d 966, 968 (N.Y. Sup. Ct. 1982).

341. Brazer v. Borough of Mountainside, 55 N.J. 456, 471, 262 A.2d 857, 865 (1970).

also possesses powers that are necessarily implied to permit the government to accomplish the purposes of the state legislation. The courts vary in the breadth that they give to the notion of "necessarily implied" powers. Jurisdictions that continue to follow Dillon's rule[342] construe local powers narrowly,[343] while other jurisdictions liberally construe municipal authority.[344] Thus, courts have upheld the authority to require a nonstatutory bond when the requirement assisted the developer in qualifying for government guaranteed financing.[345] Courts also have permitted local governments to require a cash deposit in addition to the statutorily required bond,[346] to require a maintenance bond guaranteeing against defects in the improvements,[347] and to require the payment of inspection fees.[348] Flexible regulations are helpful to the local government and the developer because subdivision improvements can be related more effectively to the needs of the particular type of development. Courts have upheld a system of classifying developments as being within the power of the local government to provide reasonable regulations for development.[349]

In addition to the limitations imposed by state law, a local government's power is limited by its own ordinances and regulations. Local governments must base any decision to approve or disapprove a subdivision or to require certain improvements on factors that can be found in the local regulations,[350] and the reviewing authority cannot rely on

342. *See* B. ELLICKSON & A. TARLOCK, *supra* note 2, at 36-37 (discussing the doctrine that narrowly construes local government powers and is named for its advocate, Judge Dillon). *See also* D. MANDELKER, D. NETSCH, & P. SALSICH, STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM 83-89 (2d ed. 1983) (discussing Dillon's Rule).

343. *See* Hylton Enters., Inc. v. Board of Supervisors, 220 Va. 435, 441, 258 S.E.2d 577, 581 (1979) (finding no power to require off-site road improvements).

344. *See* Savonich v. Township of Lawrence, 91 N.J. Super. 228, 295, 219 A.2d 902, 906 (Law Div. 1966) (applying the New Jersey Constitution).

345. Genesee County Bd. of Road Comm'rs v. North Am. Dev. Co., 369 Mich. 229, 235, 119 N.W.2d 593, 597 (Law Div. 1963).

346. Savonich v. Township of Lawrence, 91 N.J. Super. 288, 295, 219 A.2d 902, 906 (Law Div. 1966).

347. Legion Manor, Inc. v. Municipal Council, 49 N.J. 420, 424, 231 A.2d 201, 204 (1967).

348. Economy Enters., Inc. v. Township Comm., 104 N.J. Super. 373, 379, 250 A.2d 139, 142 (App. Div. 1969) (holding, however, the requirement in this case invalid for lack of standards).

349. Delight, Inc. v. Baltimore County, 624 F.2d 12, 14-15 (4th Cir. 1980).

350. Canter v. Planning Bd., 4 Mass. App. Ct. 306, 309, 347 N.E.2d 691, 693 (1976)

facts not in the record when rendering its decision.[351]

2. On-Site Subdivision Improvement Requirements

The authority to require subdivision improvements derives from state statutes and local ordinances. These laws have two essential features: they require the developer to make certain improvements and they require or presume that the developer will dedicate the improvements to the local government, which eventually will take responsibility for maintaining the improvements. Most subdivision improvement requirements are for on-site improvements, those within the boundaries of the subdivision; local governments, however, more frequently are requiring off-site improvements in addition. Some question exists whether a local government may require on-site improvements that the developer will not dedicate to the public, but will remain in private hands. For example, may the local government require the developer to pave roads if the government will never take responsibility for these roads? May the government require construction of a clubhouse for a homeowners' association? Assuming that the government may mandate such requirements, it is questionable whether the local government may require a bond to secure completion of private improvements and common amenities. That authority must be found within the state enabling statute or necessarily implied from it.

Subdivision control constitutes an economic regulation that is subject to a low level of scrutiny by the courts.[352] Thus, a subdivision improvement requirement is valid when it has a reasonable relationship to the promotion of public health, safety, and welfare.[353] A reasonable nexus also must exist between the requirements imposed on the developer and the demands created by his subdivision.[354] In fact, neither requirement imposes a very significant barrier for upholding on-site im-

(local government could not refuse to approve subdivision because of access and traffic problems when local ordinances did not include these factors as a basis for decision).

351. Kaufman & Gold Constr. Co. v. Planning & Zoning Comm'n, 298 S.E.2d 148, 155-56 (W. Va. 1982).

352. Delight, Inc. v. Baltimore County, 475 F. Supp. 754, 758-59 (D. Md. 1979), *aff'd*, 624 F.2d 12 (4th Cir. 1980).

353. Petterson v. City of Naperville, 9 Ill. 2d 233, 246, 137 N.E.2d 371, 379 (1956) (upholding road improvement requirements).

354. *See, e.g.*, Lake Intervale Homes, Inc. v. Township of Parsippany-Troy Hills, 28 N.J. 423, 442, 147 A.2d 28, 39 (1958) (the court struck down on-site water main requirements because the government had no standards for determining whether the improvements were required by the particular development).

provements that generally are necessary to provide an adequate infrastructure for the development.

The courts have upheld nearly all of the great array of on-site improvements required of developers. Road improvement requirements were the earliest concern of the subdivision control scheme, and the courts upheld requirements for widening, grading, paving, and dedicating roads within the subdivision.[355] Surprisingly, litigation over road improvement requirements continues and the courts continue to uphold these requirements.[356] Courts have not been as receptive to requirements that developers reserve right-of-ways for future road construction, reasoning that the present development fails to generate future needs.[357] Another major requirement for most subdivisions is a water system. Consequently, courts have upheld requirements that the developer construct and install central water mains,[358] as well as central water systems.[359] Similarly, courts have upheld requirements that

355. *See* Los Angeles County v. Margulis, 6 Cal. App. 2d 57, 59, 44 P.2d 608, 609 (1935) (upholding improvement requirements for dedicated roads on the theory that the government would be liable for injuries sustained on the roads); Ridgefield Land Co. v. City of Detroit, 241 Mich. 468, 472-73, 217 N.W.2d 58, 59 (1928) (upholding road improvement and dedication requirements on a theory of privilege and voluntariness); Brous v. Smith, 304 N.Y. 164, 171, 106 N.E.2d 503, 507 109 N.Y.S.2d 289, 291 (1952) (upholding access improvements before a building permit could issue).

356. *See* Township of Hampden v. Tenny, 32 Pa. Commw. 301, 307, 379 A.2d 635, 638 (1977); City of Bellefontaine Neighbors v. J.J. Kelley Realty & Bldg. Co., 460 S.W.2d 298, 304 (Mo. App. 1970).

357. *See, e.g.*, Brazer v. Borough of Mountainside, 55 N.J. 456, 466, 262 A.2d 857, 862 (1970); 181, Inc. v. Salem County Planning Bd., 133 N.J. Super. 350, 360, 336 A.2d 501, 505 (Law Div. 1975). *But see* Krieger v. Planning Comm'n, 224 Md. 320, 323, 167 A.2d 885, 886-87 (1961) (upholding a requirement that a developer's plan take into account the widening of an unlimited access road).

358. *See, e.g.*, Crownhill Homes, Inc. v. City of San Antonio, 433 S.W.2d 448, 459 (Tex. Civ. App. 1968) (upholding a requirement that the subdivision developer install on-site water mains).

359. Zastrow v. Village of Brown Deer, 9 Wis. 2d 100, 108, 100 N.W.2d 359, 364 (1960). *Crownhill* and *Zastrow* relied on two earlier cases in which the courts held that the government was not required to compensate developers for the costs of central improvements, including water systems, after annexing the subdivisions and taking over operation of the improvements. Trentman v. City and County of Denver, 236 F.2d 951, 954 (10th Cir. 1956); City of Danville v. Forest Hills Dev. Corp., 165 Va. 425, 431, 182 S.E. 548, 551 (1935). In each case, the court reasoned that the improvements already had been dedicated to the beneficial use of the citizens in the subdivision and that the developer suffered no damages when the city took control of the improvements. *Trentman*, 236 F.2d at 954; *City of Danville*, 165 Va. at 432, 182 S.E. at 551.

developers construct sewers[360] and even have suggested that the municipality can require the developer to establish a sewer district.[361] Other requirements that courts have upheld include storm drains,[362] curbs and gutters,[363] sidewalks,[364] landscaping,[365] and fire protection systems.[366] The courts even have upheld requirements that subdivisions obtain easements for the purposes of access[367] and drainage.[368]

3. Standards for On-Site Improvements

Unambiguous standards for imposing subdivision improvement requirements serve two purposes. First, the standards place the developer on notice as to what the government probably will require of him if he intends to secure approval of his subdivision. Second, standards constrain official action, limiting the opportunity for arbitrary and discriminatory decision-making. Thus, the courts generally have held that subdivision regulations must set reasonable standards to restrain the discretion of decision-makers and must be reasonably definite in order for property owners to know in advance what is required of them.[369] General standards are permissible if they can be applied to concrete fact situations and are sufficient to limit discretion.[370]

Stating the test for sufficient standards is easier than applying it to

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360. *See* City of Bellefontaine Neighbors v. J.J. Kelley Realty & Bldg. Co., 460 S.W.2d 298, 304 (Mo. App. 1970).

361. Medine v. Burns, 29 Misc. 2d 890, 896, 208 N.Y.S.2d 12, 16 (N.Y. Sup. Ct. 1960).

362. Delight, Inc. v. Baltimore County, 475 F. Supp. 754, 760 (D. Md. 1979), *aff'd*, 624 F.2d 12 (4th Cir. 1980).

363. Petterson v. City of Naperville, 9 Ill. 2d 233, 245, 137 N.E.2d 371, 378 (1956).

364. City of Bellefontaine Neighbors v. J.J. Kelley Realty & Bldg. Co., 460 S.W.2d 298, 304 (Mo. App. 1970).

365. Mac-Rich Realty Constr., Inc. v. Planning Bd. of Southborough, 4 Mass. App. Ct 79, 87, 341 N.E.2d 916, 919 (1976).

366. Town of Wheatland v. Allison, 577 P.2d 1006, 1010 (Wyo. 1978) (construing a local ordinance).

367 Town of Stoneham v. Savelo, 341 Mass. 456, 459, 170 N.E.2d 417, 419 (1960) (enforcing the obligation of a developer to access a public road when the developer was unable to obtain an easement across neighboring property).

368. County Council v. Lee, 219 Md. 209, 216, 148 A.2d 568, 572 (1959).

369. *See* Singer v. Davenport, 264 S.E.2d 637, 642 (W. Va. 1980); Sonn v. Planning Comm'n, 172 Conn. 156, 159, 374 A.2d 159, 161 (1976).

370. Parker v. Board of County Comm'rs, 93 N.M. 641, 643, 603 P.2d 1098, 1100 (1979) (citing City of Santa Fe v. Gamble-Skogmo, Inc., 73 N.M. 410, 417, 389 P.2d 13, 18 (1964)).

actual situations. Courts have invalidated subdivision regulations as being too vague when they required that a subdivision have adequate access,[371] or mandated "harmonious development,"[372] or permitted parallel streets in cases of "unusual topography,"[373] or simply failed to place the developer on adequate notice that the government would impose water and drainage requirements.[374] On the other hand, the courts have upheld a state law requiring "sufficient and adequate roads," a "well-planned" development and "sufficient information" to be submitted to the planning authority,[375] as well as a local ordinance where the planning authority "might" require extra-wide streets and bituminous concrete berms.[376]

4. Off-Site and Excess Capacity Improvements

Although subdivision improvement requirements originally focused on on-site construction of the infrastructure of the development, local governments increasingly have attempted to require developers to construct off-site improvements and on-site improvements of an excess capacity that are capable of serving areas other than the subdivision. Off-site and excess capacity improvement requirements create analytical problems for the courts, which generally have held that the government must relate the required improvement to the demands created by the development.[377] This nexus obviously exists when improvements are constructed for the exclusive use and benefit of persons in the subdivision, but the nexus becomes attenuated when off-site and excess capacity improvements are involved. The problem is similar to that posed by many dedication and in lieu fee systems.

The courts have enunciated several standards for determining whether a given improvement, dedication, or in lieu fee is sufficiently

371. North Landers Corp. v. Planning Bd., 9 Mass. App. Ct. 193, 195, 400 N.E.2d 273, 275 (1980).

372. Kaufman & Gold Constr. Co. v. Planning & Zoning Comm'n, 298 S.E.2d 148, 154-55 (W. Va. 1982).

373. Sonn v. Planning Comm'n, 172 Conn. 156, 160, 374 A.2d 159, 161 (1976).

374. Castle Estates, Inc. v. Park & Planning Bd., 344 Mass. 329, 334, 182 N.E.2d 540, 545 (1962).

375. Parker v. Board of County Comm'rs, 93 N.M. 641, 643, 603 P.2d 1098, 1100 (1979).

376. Mac-Rich Realty Constr., Inc. v. Planning Bd., 4 Mass. App. Ct. 79, 83, 341 N.E.2d 916, 919 (1976).

377. *See, e.g.*, Lake Intervale Homes, Inc. v. Township of Parsippany-Troy Hills, 28 N.J. 423, 441, 147 A.2d 28, 39 (1958).

related to the demands created by the subdivision. The Illinois Supreme Court established the most grudging test in *Pioneer Trust & Savings Bank v. Village of Mount Prospect.*[378] The court declared that a dedication requirement must be related to a demand that was "specifically and uniquely attributable" to the subdivision.[379] More commonly, the courts state that the subdivision requirement must be "reasonably related" to the needs created by the subdivision.[380] The California courts apply the least restrictive test for subdivision requirements and uphold requirements as a condition on the privilege to subdivide land even when the subdivision creates no new demand.[381]

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378. 22 Ill. 2d 375, 176 N.E.2d 799 (1961).

379. *Id.* at 381, 176 N.E.2d at 802.

380. *See, e.g.*, Collis v. City of Bloomington, 310 Minn. 5, 13, 246 N.W.2d 19, 23-24 (1976) (in lieu fees for parks and playgrounds); Land/Vest Properties, Inc. v. Town of Plainfield, 117 N.H. 817, 823, 379 A.2d 200, 204 (1977) (off-site road improvements); Jordan v. Menomenee Falls, 28 Wis. 2d 608, 617-18, 137 N.W.2d 442, 447 (1965) (fees for school, park, and recreation needs), *appeal dismissed*, 385 U.S. 4 (1966).

381. *See, e.g.*, Norsco Enters. v. City of Fremont, 54 Cal. App. 3d 488, 495, 126 Cal. Rptr. 659, 663 (1976) (upholding land dedication and in lieu fee requirements for condominium conversion even though no new residents were generated). California case law manifests the difficulty that all courts have experienced in developing manageable standards for subdivision requirements. In the leading case of Ayres v. City Council, 34 Cal. 2d 31, 207 P.2d 1 (1949), the California Supreme Court upheld dedication requirements for street expansion as a reasonable exercise of the police power. The court reasoned that the subdivision of land was a privilege that was voluntarily exercised and the government could require "compliance with reasonable conditions for design, dedication, improvement and restrictive use of the land so as to conform to the safety and general welfare of the lot owners in the subdivision and of the public." *Id.* at 42, 207 P.2d at 7. Several years later, the California District Court of Appeals struck down a fee system by which a municipality collected money for the development of parks and schools and collected an in lieu fee for development of drainage projects. Kelber v. City of Upland, 155 Cal. App. 2d 631, 638, 318 P.2d 561, 565 (1958). The court stated: "It rather clearly appears that these fee provisions are fund raising methods for the purpose of helping to meet the future needs of the entire city . . . and are not reasonable requirements for the design and improvements of the subdivision itself." *Id.* at 638, 318 P.2d at 565. In Wine v. Council of City of Los Angeles, 177 Cal. App. 2d 157, 170-71, 2 Cal. Rptr. 94, 103-04 (1960), a California appellate court followed *Kelber* when it held that the City of Los Angeles could not require off-site road improvements. In City of Buena Park v. Boyar, 186 Cal. App. 2d 61, 66-67, 8 Cal. Rptr. 674, 678-79 (1960), however, a California appellate court distinguished *Kelber* when it held that fees for the construction of a drainage facility were valid because the facility was designed for the direct benefit of residents in the subdivision.

A second major decision of the California Supreme Court altered the history of subdivision control law in that state. In Associated Home Builders, Inc. v. City of Walnut Creek, 4 Cal. 3d 633, 484 P.2d 606, 94 Cal. Rptr. 630, *appeal dismissed*, 404 U.S. 878 (1971), the court upheld dedication and in lieu fees for the preservation of open space and recreation areas. The court rejected a test based on a specific nexus to the need

Road improvements have been the most litigated off-site requirement as local governments attempt to shift the cost of upgrading roads that residents in the subdivision will use. Several courts, ruling on statutory grounds, have held that local governments have no authority to require developers to improve roads outside the boundaries of the subdivision.[382] Other courts, applying a rational nexus test, have rendered both favorable and unfavorable opinions concerning the right of the government to impose off-site road improvement requirements.[383] The results in these cases turn on whether the local government can demonstrate that the need for road improvement is attributable largely to the increased demand created by the subdivision.[384] One court has upheld a trial court's determination that a municipal zoning commission could not force a developer to acquire off-site rights-of-way, although the commission could require him to improve an off-site road.[385]

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generated by new subdivision and stressed subdivision requirements as a legitimate exercise of the police power. 4 Cal. 3d at 640, 484 P.2d at 610, 94 Cal. Rptr. at 634. The California Court of Appeal subsequently has upheld fee requirements for a condominium conversion project under the state's subdivision control laws even though no new demand was created and no open space area was depleted. Norsco Enters. v. City of Freemont, 54 Cal. App. 3d 488, 495, 126 Cal. Rptr. 659, 663 (1976). For an excellent discussion of the judicial standards used in subdivision requirement cases, see generally Note, *supra* note 17.

382. Arrowhead Dev. Co. v. Livingston County Road Comm'n, 413 Mich. 505, 512-13, 322 N.W.2d 702, 707 (1982); Medine v. Burns, 29 Misc. 2d 890, 892, 208 N.Y.S.2d 12, 14-15 (N.Y. Sup. Ct. 1960); Hylton Enters., Inc. v. Board of Supervisors, 220 Va. 435, 440-41, 258 S.E.2d 577, 581 (1979) (affirming adherence to Dillon's Rule). *See also* Wine v. Council of Los Angeles, 177 Cal. App. 2d 157, 170-71, 2 Cal. Rptr. 94, 103-04 (1960) (the court held that a municipality could not require off-site road improvements but was unclear concerning the basis for its decision).

383. *Compare* KBW, Inc. v. Town of Bennington, 115 N.H. 392, 395, 342 A.2d 653, 655 (1975) (upholding an off-site requirement) *with* Land/Vest Properties, Inc. v. Town of Plainfield, 117 N.H. 817, 823, 379 A.2d 200, 205 (1977) (off-site requirement invalidated).

384. In *Land/Vest*, the New Hampshire Supreme Court distinguished its earlier opinion in *KBW* on the grounds that in *KBW* the road that the municipality required the developer to improve served no other residents and only fronted the developer's property, while in *Land/Vest* the road served two residences and three lots not owned by the developer and improvements would extend beyond the proposed subdivision's frontage. 117 N.H. at 822, 379 A.2d at 203. *Land/Vest* is one of many decisions in which courts analogize road improvements to special assessments. 117 N.H. at 823, 379 A.2d at 204. The courts reason that if the local government could have constructed the improvement and assessed the benefited property to recoup its costs, it can require the developer to undertake the improvements and pass the costs along to lot and homebuyers in the subdivision.

385. Robert Mueller Assocs. v. Zoning Hearing Bd., 30 Pa. Commw. 386, 389-90,

A second problem area for the courts concerns drainage requirements. The Colorado Supreme Court held that a municipality could not force a developer to pay for the entire cost of a drainage system that would serve an area larger than the proposed subdivision.[386] In a similar case, the New Jersey Supreme Court held that a municipal planning commission could not require a developer to pay twenty thousand dollars toward the cost of an off-site drainage facility based on the benefit of the facility to the developer's property when general revenues were to pay for the balance of the project.[387]

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373 A.2d 1173, 1174-75 (1977). The *Robert Mueller* court offered this justification for off-site improvements:

> The rationale for imposing off-site costs is not to transfer all costs of development from municipalities to private developers. The primary responsibility for providing these services lies with local governments. The purpose of imposing reasonable off-site costs on developers is to cushion municipalities from the effect of rapid, large-scale development.

30 Pa. Commw. at 389-90, 373 A.2d at 1175. Although the local government can construct and install all improvements and assess the eventual property owners in the subdivision, the government will run the risk that the development may fail and it will be unable to recoup its costs.

386. Wood Bros. Homes, Inc. v. City of Colorado Springs, 193 Colo. 543, 548, 568 P.2d 487, 490-91 (1977). The facts in *Wood Brothers* revealed that the city would have required the developer to construct a drainage channel that would have benefited an area of the city at a cost of $282,000. *Id.* at 547, 568 P.2d at 489. Although the trial court held the requirement unconstitutional, the Colorado Supreme Court ruled only that the language in the local ordinances did not permit the city to apply the requirement to the facts of the case. *Id.* at 546, 568 P.2d at 490.

387. Divan Builders, Inc. v. Planning Bd., 66 N.J. 582, 603, 334 A.2d 30, 41 (1975). The *Divan* court developed a more sophisticated approach to determining the proportion of costs for off-site or excess capacity improvements that a municipality can force a developer to assume. The court reasoned that the government can require the developer to pay costs based on the extent to which the improvement has benefited the property—as long as the municipality assesses other benefited property—plus the difference in the total cost of the improvement and the aggregate value to all benefited property. *Id.* at 602, 334 A.2d at 40. The court reasoned that it was fair to require the developer to pay the difference because the subdivision created the need for the off-site improvement. *Id.*, at 602, 334 A.2d at 40. In truth, the "need" was no more created by the subdivision than by those that used city services before the new subdivision; the developer's proposed use merely creates a demand that existing systems cannot satisfy. Thus, it is questionable whether the municipality should force the developer to pay the additional cost of constructing improvements simply because he is "the last one in." A more pragmatic justification is that because the local government lacks the capital resources to increase the capacity of city services and because the development—probably residential—is unlikely to pay for itself through generating tax revenues, it is reasonable to require the developer to pay for the cost of improvements up front. Although a perfect match does not exist between the costs that the developer incurs and benefits that he receives, the requirement should withstand constitutional scrutiny. Theoretically, the

Developers probably will continue to call upon the courts to determine the legitimate proportion of off-site and excess improvement costs that municipalities can shift to developers as the local governments attempt to avoid repeating the financial disasters of the 1920s and 1930s. It remains unlikely, however, that the various state courts will reach a concensus as to the proper standards to apply.

5. Post-Approval Requirements and Vested Rights

Somewhere in the subdivision approval process the developer or purchaser in the subdivision acquires a right to construct or occupy buildings that the local government cannot deny or modify. The difficulty is determining exactly when these rights "vest." Vesting is a difficult subject because it remains unclear whether the vesting of rights is based on state statutory laws, equity, constitutional law, or some combination of the three. It is more certain that vesting involves a balancing of public and private interests. This section explores several issues related to vested rights: the effect of a unilateral filing of a subdivision plat; additional or modified requirements that the government can impose on a developer after preliminary approval and after final approval; and the requirements that the government can impose on purchasers in a subdivision.

The few cases that have resolved the issue agree that subdivision plats filed prior to enactment of a subdivision control law are subject to the new regulations so long as no substantial construction has taken place.[388] Unilateral plat filings occurred at a time when approval of the local government was not required before the developer could convey lots in the subdivision. The right to record a plat to facilitate conveyancing, however, was not meant to vest any building right in the person filing the plat or a person purchasing a lot in the subdivision.[389]

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developer will recoup his costs by passing them through to lot and homebuyers. If he cannot recoup all of his costs, this means only that the developer's profit margin will be reduced and such a diminution in value, standing alone, is insufficient to invalidate on constitutional grounds the off-site or excess capacity improvement requirement. Of course, the risk exists that the requirements may deter development, cause the development to fail, or force the price of housing beyond the financial capabilities of many potential homebuyers.

388. *See* Dawe v. City of Scottsdale, 119 Ariz. 486, 487, 581 P.2d 1136, 1137 (1978); Lake Intervale Homes, Inc. v. Township of Parsippany-Troy Hills, 28 N.J. 423, 437, 147 A.2d 28, 37 (1958).

389. *See* Dawe v. City of Scottsdale, 119 Ariz. 486, 487, 581 P.2d 1136, 1137 (1978); Lake Intervale Homes, Inc. v. Township of Parsippany-Troy Hills, 28 N.J. 423, 433, 147 A.2d 28, 33 (1958).

A more difficult problem arises when the subdivision proposal has received at least preliminary approval from the local government. Most courts agree that the government cannot require the developer to construct additional improvements after it has granted final approval and accepted a bond to secure the developer's performance;[390] however, the rights acquired by preliminary approval of a subdivision plat are less clear. Most of the case law arose out of New Jersey when state law provided that the general terms and conditions of subdivision approval could not be modified for three years after preliminary approval. State law, however, appeared to permit the local government to increase improvement requirements after preliminary approval, but before final approval. In a series of cases, the New Jersey Supreme Court determined that minimum lot size was a term or condition of approval,[391] while paving requirements,[392] the existence of sidewalks, and the width of streets[393] were improvements that a local government could impose after preliminary approval.

The extent to which development rights vest after preliminary approval poses a difficult problem because of the clash between public and private interests. On the one hand, the developer must determine the costs of development before committing himself to a project.[394] At the same time, the government must protect the health and safety of its citizens and should not be forced to permit the developer to construct inadequate improvements.[395] Under many state laws and local ordinances, however, the local government may not require additional or materially different improvements after preliminary approval unless it pays for the modification.

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390. *See, e.g.*, McKenzie v. Arthur T. McIntosh & Co., 50 Ill. App. 2d 370, 378, 200 N.E.2d 138, 143 (1964); City of Summit v. Horton Corp., 70 N.J. Super. 529, 540, 176 A.2d 34, 46 (Ch. Div. 1961), *aff'd*, 76 N.J. Super. 346, 14 A.2d 539 (App. Div. 1962). *But see* Slagle Constr. Co. v. County of Contra Costa, 67 Cal. App. 3d 559, 564, 136 Cal. Rptr. 748, 750 (1977) (developer does not have a vested right to a building permit after final plat approval).

391. Hilton Acres v. Klein, 35 N.J. 570, 577-78, 174 A.2d 465, 469 (1961).

392. Levin v. Township of Livingston, 35 N.J. 500, 520, 173 A.2d 391, 400 (1961). *See also* Ridgemont Dev. Co. v. City of E. Detroit, 358 Mich. 387, 397, 100 N.W.2d 301, 306 (1960).

393. Pennyton Homes, Inc. v. Planning Bd., 41 N.J. 578, 583, 197 A.2d 870, 872 (1964).

394. *See* Levin v. Township of Livingston, 35 N.J. 500, 512, 173 A.2d 391, 397 (1961).

395. Pennyton Homes, Inc. v. Planning Bd., 41 N.J. 578, 584, 197 A.2d 870, 873 (1964).

After final subdivision approval and acceptance of a performance bond by the local government, the government cannot deny purchasers in a subdivision certificates of occupancy because the developer defaults on the subdivision improvement agreement; rather, the government's remedy is limited to recovery under the bond.[396] Similarly, when individuals purchase lots in a subdivision that was not approved as required by law, the government cannot require these purchasers to comply with subdivision regulations.[397]

B. *Suits Against the Government by Purchasers in or Neighbors of the Subdivision*

1. Suits to Require a Bond

Relatively few cases discuss the general duty of the local government to obtain a bond or other security to assure completion of subdivision improvements. Possibly, governments rarely may fail to obtain security or parties that may be affected by the failure do not receive notice until it is too late to object. At some later date, the government may be required to complete improvements at its own expense if the developer fails to complete the project and security was not obtained. One court has held that a local government is not free to complete improvements and assess the costs to lot owners when state law requires completion of improvements or a bond before final approval.[398]

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396. Key Fed. Sav. & Loan Ass'n v. Anne Arundel County, 54 Md. App. 633, 642, 460 A.2d 86, 91 (1983); J.D. Land Corp. v. Allen, 114 N.J. Super. 503, 509, 277 A.2d 404, 408 (App. Div. 1971); Incorporated Village of Northport v. Guardian Fed. Sav. & Loan Ass'n, 87 Misc. 2d 344, 347, 384 N.Y.S.2d 923, 926 (N.Y. Sup. Ct. 1976).

397. *See* Munns v. Stenman, 152 Cal. App. 2d 343, 352, 314 P.2d 67, 73 (1957) (even if purchasers had bought into an illegal subdivision, the government could not require them to join together to construct subdivision improvements because persons that needed the improvements would be at the mercy of lot owners that were not interested in completing improvements). *Cf.* Keizer v. Adams, 2 Cal. 3d 976, 980-81, 471 P.2d 983, 986, 88 Cal. Rptr. 183, 185-86 (1970) (the municipality could not deny building permits to persons who purchased lots in an illegal subdivision, but the municipality could require the purchasers to comply with reasonable requirements, including the construction of improvements, before the permits would issue; thus, although the strict letter of California's Subdivision Map Act was not followed, its basic purpose was served). *But cf.* Slagle Constr. Co. v. County of Contra Costa, 67 Cal. App. 3d 559, 564, 136 Cal. Rptr. 748, 750 (1977) (developer could not sue the county for failure to issue building permits after final plat approval).

398. Friends of the Pine Bush v. Planning Bd., 86 A.D.2d 246, 249, 450 N.Y.S.2d 966, 968 (N.Y. Sup. Ct. 1982). Although the result in this case is correct, it is curious because the holding reverses the traditional model of government provision of services in favor of developer provided services. While most cases question whether the govern-

When the local government fails to obtain a bond to secure performance by the developer or obtains an inadequate bond, residents in the subdivision may be able to force the government to construct or complete the improvements.[399] Apparently, the government may not assess the costs of improvements against lot owners.[400]

2. Government Liability Regarding Improvements

Because local governments require improvements and review their adequacy, they may be sued when the improvements cause injury to others. States that follow the doctrine of immunity for governmental functions or discretionary acts provide a shield against local liability.[401] A court also may refuse to hold liable a local government for injuries caused by improvements because the government has no duty to protect persons living outside the government's jurisdiction.[402] Conversely, a local government is not liable when it fails to expand its

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ment can require the developer to make improvements, *Pine Bush* holds that the government cannot do this in the case of a new subdivision.

399. *See* Safford v. Board of Comm'rs, 35 Pa. Commw. 631, 638, 387 A.2d 177, 182 (1978). *See also* Kennedy v. Lehman Township, 74 Pa. Commw. 377, 379, 459 A.2d 921 922, (1983) (suggesting that the plaintiff may be able to bring himself within the rule of *Safford*).

400. The *Safford* court stressed that the local government was required to complete improvements "at its own expense." 35 Pa. Commw. at 638, 387 A.2d at 180. The city likely would have a cause of action against the developer if the city obligated the developer to construct improvements even though the developer obtained no bond. The developer, however, may be judgment-proof. Although it appears reasonable to permit the government to assess costs against property in the subdivision if it is assumed that lot owners did not already pay for improvements, it is likely that the developer incorporated the estimated cost of improvements into the selling price of lots or homes and then failed to construct improvements. If the government is permitted to assess property owners for its cost of construction, they will have paid for the improvements twice.

As an alternative to suing the government to force it to complete improvements, one plaintiff sought to collect under her title insurance policy when local officials refused to issue a building permit because the developer failed to complete improvements in the subdivision. Hocking v. Title Ins. & Trust Co., 37 Cal. 2d 644, 645, 234 P.2d 625, 626 (1951). Unfortunately for the plaintiff, the court found that the developer's failure did not affect the marketability of the plaintiff's title. *Id.* at 652, 234 P.2d at 629.

401. *See, e.g.*, Panepinto v. Edmart, Inc., 129 N.J. Super. 319, 325, 323 A.2d 533, 536-37 (App. Div. 1974) (good faith decisions made as part of discretionary functions and duties cannot be the basis for liability); Brenner v. Township of Jackson, 94 N.J. Super. 445, 450, 228 A.2d 721, 724 (App. Div. 1967) (discretionary functions arising out of planning activities are immune from liability).

402. *See* Breiner v. C&P Home Builders, Inc., 536 F.2d 27, 32-33 (3d Cir. 1976). The court determined that the local ordinance that required a drainage system for the proposed subdivision did not create a duty to protect persons that lived outside the

sewer plant to keep pace with growth resulting in injury to various residents in the city.[403]

In *Sheffet v. County of Los Angeles*,[404] a California appellate court held that a local government may be liable when approved subdivision improvements cause injury to others. As a result of governmentally required road improvements, the plaintiff's land was subjected to an increased flow of surface water that consequently diminished the value of his land.[405] The court held that an action for inverse condemnation would lie against the government and that the plaintiff could obtain an injunction to remedy poorly designed landscaping.[406]

3. Suits to Require the Government to Enforce Its Rights

Although no cases exist where citizens successfully have required a local government to exercise its rights against a developer or surety after a default, one case does report that citizens successfully forced a local government to complete improvements after a default by a bonded developer.[407] One only can presume that the government exer-

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borough. The court stated: "[W]e are satisfied that the ordinance imposed no duty on the Borough to protect land in adjacent areas from surface water drainage." *Id.* at 32.

403. Barney's Furniture Warehouse of Newark, Inc. v. City of Newark, 62 N.J. 456, 469, 303 A.2d 76, 83 (1973). The court's holding in *Barney's Furniture Warehouse* is important because it suggests that a local government cannot be liable for failure to impose improvement requirements on the subdivision developer when that failure results in overtaxing municipal services and injury to others. The court did not decide *Barney's Furniture Warehouse* on the issue of immunity, but on the basis of a lack of duty. *Id.* at 469, 303 A.2d at 83.

404. 3 Cal. App. 3d 720, 735, 84 Cal. Rptr. 11, 21-22 (1970).

405. Id. at 727, 84 Cal. Rptr. at 14.

406. *Id.* at 739, 84 Cal. Rptr. at 23. *But see* Agins v. City of Tiburon, 24 Cal. 3d 266, 277, 598 P.2d 25, 32, 157 Cal. Rptr. 372, 378 (1979), *aff'd*, 447 U.S. 255 (1980) (rejecting a claim of inverse condemnation for down zoning). For a discussion of *Agins* and subsequent developments, see generally Stoebuck, San Diego Gas: *Problems, Pitfalls and a Better Way*, 25 WASH. U.J. URB. & CONTEMP. L. 3 (1983). Although injunctive relief may be appropriate to require local governments to correct improperly designed improvements for which they have assumed responsibility, public policy cautions against permitting damage actions against municipalities because of the enormous potential liability. The courts that boldly declare that the government had no duty to the injured party probably are influenced by the policy consideration without clearly articulating it.

407. Norton v. First Fed. Sav., 128 Ariz. 176, 179, 624 P.2d 854, 855-56 (1981). *See also* Gordon v. Robinson Homes, Inc., 342 Mass. 529, 533, 174 N.E.2d 381, 384 (1961) (suggesting that lot owners mandamus the local government to enforce their rights).

cised its rights under the bond.[408]

C. *Government Suits on Default*

1. Accrual of the Cause of Action

When the government accepts a bond or other security to guarantee the completion of subdivision improvements, the government sets a deadline for completion, the typical period being two years. The government may declare a default at the end of the specified period if the improvements are not completed[409] or are otherwise defective.[410] It is not necessary that the developer and the government enter into an underlying written contract before the duty of the surety will arise because, on the basis of the bond, the courts will find an implied in fact contract.[411] When it is clear that the developer has abandoned the project and cannot possibly complete improvements within the permitted time, the government may declare an anticipatory breach.[412]

When the developer receives preliminary plat approval, he is under no obligation to complete the development or any improvements in the development. He simply will be unable to convey any lots in the devel-

408. Assuming that citizens forced the government to complete improvements prior to obtaining a judgment against the developer or surety, the city could be left with the costs of completion if a successful defense is available to the developer or surety. Public policy cautions against imposing a duty on the government until it has had an opportunity to litigate its claim. Thus, the original question is whether it is discretionary to exercise one's right under a performance bond or if the government is under a duty to attempt to collect a judgment after the developer's default.

409. *See* Sherwood Forest No. 2 Corp. v. City of Norman, 632 P.2d 368, 370 (Okla. 1980) (cause of action accrues on the expiration of the two year period in the bond); City of Norman v. Liddell, 596 P.2d 879, 882 (Okla. 1979) (action may be brought on expiration of the two year period set for completion).

410. *See* Town of Brookfield v. Greenridge, Inc., 177 Conn. 527, 532, 418 A.2d 907, 911 (1979) (implied obligation to construct improvements according to industry standards). *Town of Brookfield* also demonstrates that the bond constitutes a sufficient basis for the surety's obligation and no express contract for completion of improvements is required to create the surety's duty to pay on default. *Id.* at 530, 418 A.2d at 909. Moreover, a bond will incorporate the minimum requirements reflected in the local subdivision regulations and the courts will charge the surety with knowledge of these regulations. *See* Indian River County v. Vero Beach Dev., Inc., 201 So. 2d 922, 924 (Fla. Dist. Ct. App. 1967); City of Medina v. Holdridge, 46 Ohio. App. 2d 152, 156, 346 N.E.2d 339, 342 (1970).

411. *See* Fireman's Fund Indem. Co. v. County of Sacramento, 179 Cal. App. 2d 319, 321-22, 3 Cal. Rptr. 607, 608 (1960). *See also supra* note 410.

412. Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 32-33, 245 S.E.2d 425, 427 (1978).

opment because he has not obtained the government's final approval. The situation becomes more complicated when the developer posts bond to secure completion of improvements and receives final plat approval. One may expect that the duty to complete improvements arises with final approval and that the government has a right to receive performance. Nevertheless, at least two courts have held that commencement of development is a condition precedent to the developer's duty to complete improvements. In *County of Yuba v. Central Valley National Bank, Inc.*,[413] the court found an implied condition in the letter of credit issued by the bank that secured completion of improvements that development had to commence before the bank's liability could arise.[414] In *Town of New Windsor v. Inbro Development Corp.*,[415] the court held that commencement of development was a prerequisite to the obligation to complete improvements based on the language of the local ordinance.[416] The requirement that the developer commence activities before the duty to complete improvements arises apparently is not a condition implied in law, rather the duty is implied in fact, based on the agreement of the parties, or is express, based on state laws or local ordinances.[417]

One settled point is that the local government need not complete

413. 20 Cal. App. 3d 109, 97 Cal. Rptr. 369 (1971).

414. *Id.* at 112-13, 97 Cal. Rptr. at 371-72. *But cf.* Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36-39 (Colo. 1981) (mere failure of the developer to construct improvements triggered the banks obligation under the letter of credit).

415. 112 Misc. 2d 983, 448 N.Y.S.2d 99 (N.Y. Sup. Ct. 1982).

416. *Id.* at 984, 448 N.Y.S.2d at 99. The local ordinance, following state law, provided that the government could collect bond proceeds on the developer's default only to the extent that the developer had begun construction in the development project. *Id.* at 983, 448 N.Y.S.2d at 99. Although the court speaks of a condition precedent, the issue actually is one of a lack of damages. *See also* Commonwealth v. Reliance Dev. Corp., 258 Pa. Super. 276, 279-80, 392 A.2d 792, 793 (1978) (the developer was obligated only to construct improvements as he developed and sold lots; therefore when the developer defaulted, he was obligated only for improvements required by the one lot that he had sold).

417. *See* Fireman's Fund Indem. Co. v. County of Sacramento, 179 Cal. App. 2d 319, 322, 3 Cal. Rptr. 607, 608-09 (1960). In *Fireman's Fund*, although the parties stipulated that the developer had done no work in the subdivision, the surety was liable for the developer's default. County of Yuba v. Central Valley Nat'l Bank, 20 Cal. App. 3d 109, 97 Cal. Rptr. 369 (1971), makes no reference to *Fireman's Fund*. In General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, (Colo. 1981), the Colorado Supreme Court distinguished *County of Yuba*, noting that in *General Insurance* the parties to the bond "did not condition their obligation on the development of any land adjacent to the street extensions." *Id.* at 758-59 n.7. The court continued: "[The parties] intended to secure to the city the construction and installation of the street exten-

improvements before it commences an action on a bond or other security.[418] This rule is sensible because the purpose of the bond or other security arrangement is to protect the government from completing improvements at its own expense. The government should not be forced to spend general revenues or incur indebtedness prior to bringing an action on the security agreement.[419]

2. Measure of Damages

The courts unanimously have held that the bond securing completion of subdivision improvements is an indemnification bond; it is not a penal bond that will permit the government to claim the entire bond proceeds irrespective of the costs of completion.[420] The measure of the

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sions up to the amount of the bond, irrespective of the commencement of actual construction of road improvements or partial completion thereof." *Id.*

418. *See* Los Angeles County v. Margulis, 6 Cal. App. 2d 57, 60, 44 P.2d 608, 609 (1935); General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, 759 (Colo. 1981); Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 797, 567 P.2d 642, 648 (1977).

419. If the government does borrow funds to complete improvements, the surety remains liable to the government because the government's damages did not disappear when it borrowed funds. Although this liability appears to be obvious, in City of Ames v. Schill Builders, Inc., 274 N.W.2d 708, 712 (Iowa 1979), a surety attempted to avoid its obligation because the city borrowed funds to complete improvements. *See also* City of Sacramento v. Trans Pac. Indus., Inc., 98 Cal. App. 3d 389, 397, 159 Cal. Rptr. 514, 518 (1979) (holding that the city's damages continued even though a subsequent developer completed improvements in exchange for an assignment of proceeds obtained in the city's action against the surety).

420. *See* General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, 758 (Colo. 1981); Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 36-37, 245 S.E.2d 425, 430 (1978); Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 798, 567 P.2d 642, 648 (1977). In Genessee County Bd. of Road Comm'rs v. North Am. Dev. Co., 369 Mich. 229, 236, 119 N.W.2d 593, 597-98 (1963), however, the court did uphold the bond amount as liquidated damages; therefore permitting the government to collect the face amount of the bond. Most courts probably will require the government to refund any excess funds after completing the improvements unless the government establishes that the amount of the funds constituted a settlement of the government's claim against the developer and surety. *See* M. Zerman Realty & Bldg. Corp. v. Borough of Westwood, 64 N.J. 590, 591-92, 319 A.2d 441, 442 (1974) (holding that the developer was not entitled to recover excess funds after the city completed improvements because the city established the amount of the funds in settling its claim). Although the courts construe performance bonds to constitute indemnification bonds, local governments constitutionally may require a penal bond so long as the requirement is rationally related to the purposes of the statute. *See* City of Rye v. Public Serv. Mut. Ins. Co., 34 N.Y.2d 470, 473, 315 N.E.2d 458, 459, 358 N.Y.S.2d 391, 393 (1974) (stating in dictum that the court would uphold a contractor's penal bond if permitted by statute).

government's damages constitutes the reasonable cost of completing the improvements itself or through a third party.[421] Although the proper measure of damages is easy to state, the rule is difficult to apply because the extent to which improvements must be completed is not always clear. For example, if no development has taken place, the developer can assert that the government has no need to complete improvements for a nonexistent subdivision.[422] Occasionally, the agreement with the developer,[423] the local ordinance, or state law[424] limits the obligation to complete improvements to a degree commensurate with actual development. When the parties fail to agree to the contrary or when the law includes no prohibition, the local government apparently is entitled to demand completion of subdivision improvements after the developer's default if he has commenced development.

Equity may dictate that the government only complete the improvements reasonably necessary for the portions of the development that the developer completed. Nevertheless, law and policy should permit the government to complete all improvements for which the developer had been obligated. First, the developer's pledge to construct and install improvements constitutes consideration for obtaining the right to subdivide his property and convey lot and homes. The government did not promise that the development would be financially successful, nor did the developer promise conditional performance. When the government demands performance, it only requires "payment" of the consideration that it exacted in exchange for the right to subdivide. Second,

421. Los Angeles County v. Margulis, 6 Cal. App. 2d 53, 60, 44 P.2d 608, 609 (1935); General Ins. Co. of Am. v. City of Colorado Springs, 638 P.2d 752, 759 (Colo. 1981); Town of Brookfield v. Greenridge, Inc., 177 Conn. 527, 537, 418 A.2d 907, 913 (1979); Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 798, 567 P.2d 642, 648 (1977).

422. *See* County of Yuba v. Central Valley Nat'l Bank, 20 Cal. App. 3d 109, 112, 97 Cal. Rptr. 369, 371-72 (1971) (holding that commencement of development is a condition precedent to the developer's duty to complete improvements).

423. *See* Commonwealth *ex. rel.* Pa. Sec. Comm'n v. Reliance Dev. Corp., 258 Pa. Super. 276, 278, 392 A.2d 792, 793 (1978) (the agreement with the developer only required the developer to complete improvements when he developed and sold lots).

424. *See* Town of New Windsor v. Inbro Dev. Corp., 112 Misc. 2d 983, 983, 448 N.Y.S.2d 99, 99 (N.Y. Sup. Ct. 1982). In *Town of New Windsor*, state law limited collection of bond proceeds to an amount necessary to complete improvements to an extent commensurate with building development. *Id.* New York law also limits the expenditures of the government to the amount of the bond to avoid placing the burden for completing improvements on the local citizenry. *See* Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 517-18, 488 N.Y.S.2d 589, 592 (N.Y. Sup. Ct. 1980) (concerning New York's Village Law).

although the government exacted the promise to construct improvements so that it would not bear the expense of extending services to new residents, the government is harmed if the development remains incomplete—the land is subdivided, but will lie vacant generating little tax revenue. Moreover, constructing improvements only for the few homes that exist in the abandoned subdivision might be logistically impossible. Finally, the government retains an interest in promoting the marketability of the land to facilitate its full development. If it can secure performance by a subsequent developer by assigning bond proceeds in exchange for completing improvements, the government can obtain the performance that it desired. The subsequent developer may obtain an economic advantage at the cost of the original developer, but that advantage might be necessary to encourage completion of a foundered development.

Unless the parties agree otherwise, the liability of the developer is not limited to the amount of the bond, a result based either on state statutory law[425] or common law.[426] The bond only secures the developer's promise to complete improvements and if the developer is solvent, the government can collect the full amount of its damages after his breach. On the other hand, the government is limited to the face amount of the bond if it brings an action on the bond.[427] The government, however, may pursue its rights against either the principal or the

425. *See* Safford v. Board of Comm'rs, 35 Pa. Commw. 631, 641-42, 387 A.2d 177, 182 (1978) (the local ordinance specifically provided that the developer would be liable for the cost of completion if it exceeded the amount of the bond).

426. *See* Town of Brookfield v. Greenridge, Inc., 177 Conn. 527, 534, 418 A.2d 907, 912-13 (1979) (the court explained that the government's claim was in two counts, one on the bond and one on the developer's agreement to construct improvements). *See also* City of Bellefontaine Neighbors v. J.J. Kelley Realty & Bldg. Co., 460 S.W.2d 298, 300 (Mo. App. 1970) (the city's complaint was in two counts, one on the contract with the developer and one on the bond).

427. *See* Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 35, 245 S.E.2d 425, 429 (1978) (holding that a recovery on the bond is limited to the amount of the bond). Because the bond is only security for the developer's promise to perform, no reason exists why the bond should limit recovery on his promise. The government should be able to collect the cost of completion unless it has agreed that the amount of the bond is liquidated damages. *See* Town of Stoneham v. Savelo, 341 Mass. 456, 459 170 N.E.2d 417, 419 (1960) (reasonable cost of completion is the measure of damages). In practice, the bond may act as the limit of the government's recovery because the defaulting developer is judgment proof. Between coprincipals on a bond, the owner of the property will have primary liability in the case of default. *See* Dick Kelchner Excavating, Inc. v. Gene Zimmerman, Inc., 25 Ohio Misc. 133, 139, 264 N.E.2d 918, 923 (1970) (coprincipal who is owner of the property must indemnify the other principal who is the contractor).

surety because the principal always remains liable on the bond.[428]

D. *Third Party Rights on Subdivision Improvement Guarantees*

Subdivision improvement guarantees have several purposes: protection of the community from the cost of completing subdivision improvements, protection of homebuyers in the subdivision from incomplete or inadequate improvements; and protection of neighbors of the subdivision that may be injured if improvements are incomplete or inadequate. A fourth group that often seeks protection from subdivision improvement guarantees consists of contractors, subcontractors, suppliers, and laborers that work on the subdivision. The courts hold, virtually unanimously, that only the government can maintain a cause of action on an improvement guarantee. A number of courts, however, have permitted the government to assign either its cause of action or any proceeds that it might collect under the guarantee to a third party when the third party completes subdivision improvements.

1. Suits by Lot-Owners and Homeowners

A third party suit on the subdivision improvement guarantee is predicated on the theory that the local government and developer intended the guarantee to benefit the third party. Consequently, the third party should be entitled to sue in his own name as a third party beneficiary. Lot owners and homeowners in the subdivision retain the strongest argument for bringing suit because they are intended beneficiaries of the improvement guarantee. Despite rhetoric that may give lot owners and homeowners encouragement,[429] nearly all courts have held that consumers in a subdivision may not maintain an action as third party beneficiaries of a subdivision improvement guarantee.[430] A lot owner's

428. Dick Kelchner Excavating, Inc. v. Gene Zimmerman, Inc., 25 Ohio Misc. 133, 139, 264 N.E.2d 918, 922 (1970).

429. *See, e.g.*, Brous v. Smith, 304 N.Y. 164, 169, 106 N.E.2d 503, 506, 118 N.Y.S.2d 164, 169 (1952) (subdivision regulations benefit the consumer in the subdivision and the community at large). *See also* Transamerica Title Ins. Co. v. Cochise County, 26 Ariz. App. 323, 327, 548 P.2d 416, 420 (1976) (purpose of subdivision regulations "is to ensure that consumers who purchase lots in residential developments are provided with adequate streets, utilities, drainage, and generally pleasant, healthy, and livable surroundings"). *But see* Norton v. First Fed. Sav., 128 Ariz. 176, 179, 624 P.2d 854, 857 (1981) (a general purpose for a statute did not create a specific legal right in a group of persons whom the statute was designed to protect).

430. *See, e.g.*, Norton v. First Fed. Sav., 128 Ariz. 176, 180, 624 P.2d 854, 858 (1981) (lot owners were not third party beneficiaries of the performance bond or contract to post the performance bond); Gordon v. Robinson Homes, Inc., 342 Mass. 529,

inability to maintain a cause of action on a bond applies even though the bond states that it is for the purpose of protecting consumers in the subdivision; the courts hold that the government acts beyond its statutory authority when it attempts to create a cause of action in third parties.[431]

The courts' reasoning is not always clear in these cases. In *City of University City ex rel. Mackey v. Frank Miceli & Son Realty & Building Co.*,[432] the Missouri Supreme Court based its decision on the fact that third parties had no right under a performance bond[433] when, in fact, the actual reason for denying recovery was that the nature of the injury fell outside the scope of the bond.[434] In *Fleck v. National Property Management, Inc.*,[435] the Utah Supreme Court correctly addressed the

532-33, 174 N.E.2d 381, 382-83 (1961); City of University City *ex rel.* Machey v. Frank Miceli & Sons Realty & Bldg. Co., 347 S.W.2d 131, 134-35 (Mo. 1961); Fleck v. National Property Management, Inc., 590 P.2d 1254, 1256 (Utah 1979) (Hall, J., concurring).

431. *See* Gordon v. Robinson Homes, Inc., 342 Mass. 529, 531, 174 N.E.2d 381, 382 (1961). Although the bond recited that it was for the use and benefit of persons that may purchase lots in the subdivision, the court held that the lot owner could not maintain an action because the local planning authority was the primary authority for enforcing subdivision regulations. *Id.* at 531, 174 N.E.2d at 383. Thus, the local government acted beyond its statutory authority when it attempted to create a specific right in lot owners. *Id.* at 531, 174 N.E.2d at 382. The rule enunciated in *Gordon Homes* may be good policy, but it is bad law. While subdivision improvement requirements and guarantees are designed to protect the community from being saddled with the cost of completing improvements, they also serve to protect consumers. It should be within the implied power of the local government to create a right in consumers to enforce the guarantee. On policy grounds, it may be better to limit the right of action under the guarantee to the local government in order for it to control the claim against the developer or surety. *Gordon Homes* does suggest that lot owners may have a right to force the government to exercise its rights under the guarantee. *Id.* at 533, 174 N.E.2d at 384.

432. 347 S.W.2d 131 (Mo. 1961).

433. *Id.* at 134.

434. *Id.* The court stated that the "contract, ordinance and bond are not reasonably subject to the construction that they were intended for the protection of adjoining property owners." *Id.* The actual issue before the court was whether the parties intended the bond to indemnify lot owners from injury occasioned by failure to complete the improvements, or intended the bond only to secure completion. *Id.*

435. 590 P.2d 1254, 1255-56 (Utah 1979) (Hall, J., concurring). In *Fleck*, the plaintiffs were purchasers of lots subject to a prior lien. *Id.* at 1255. The subdivider had covenanted to complete improvements in the subdivision and obtained a performance bond to secure completion. *Id.* Eventually, the prior lienholder foreclosed his lien and the plaintiffs lost the property at the foreclosure. *Id.* They asserted that the developer had failed to complete improvements as promised, thereby diminishing the value of the lots and making it impractical for them to purchase at the foreclosure sale. *Id.* Justice

issue when it determined that the injury suffered by the plaintiff was not foreseeable and, therefore, denied recovery.

In *Town of Ogden v. Earl R. Howarth & Sons, Inc.*,[436] a New York trial court granted a right of action to a lot owner as a third party beneficiary of a contract between the developer and the municipality. The court reasoned that the lot owner could bring himself within the class of persons that would receive a "special benefit" from the contract.[437] Additionally, the court took notice "of the all too often evidenced difficulty of purchasers of homes in exacting fair compliance with building contracts by builder-vendors."[438]

Hall, concurring, asserted that the lot owners were not third party beneficiaries irrespective of whether the injury that they suffered was foreseeable. *Id.* at 1256-57. He noted that the local ordinance that set forth the bond requirement had as its main purpose "the objective of protecting the public by assuring that before the county takes responsibility for the maintenance of streets and other facilities that the required improvements have been completed so as not to burden the public with the added expense." *Id.*

To declare that the government alone is vested with a right on an improvement guarantee is conclusory and the courts have not explained adequately the basis for this result. One concern is that third parties can deplete the guarantee before the money can be used to complete the improvements. The purpose for which third parties can use the money, however, should be limited to completing improvements. It then would not matter who forced the developer or surety to complete the improvements. Of course, a lot owner should not be permitted to collect under a guarantee if he does not use the money for improvements. *See* Berman v. Aetna Casualty & Sur. Co., 40 Cal. App. 3d, 908, 911 115 Cal. Rptr. 566, 568 (1974) (the court stated in dictum that a lot owner that had completed improvements would have a right to intervene in a suit brought by the government to recoup his costs of completion).

436. Town of Ogden v. Earl R. Howarth & Sons, Inc., 58 Misc. 2d 213, 216, 294 N.Y.S.2d 430, 433 (N.Y. Sup. Ct. 1968).

437. *Id.* at 216, 294 N.Y.S.2d at 433.

438. *Id. Howarth* is limited to a contract between the developer and the city and does not address the issue of a third party right of action under a performance guarantee. Nevertheless, the case is significant because it contrasts the normal rule against a third party right of action on a government contract with the situation of the developer-government-homebuyer. The court noted that the class of persons that could sue as third party beneficiaries would be limited and damages would be relatively minor. *Id.* Thus, the court forthrightly addresses the policy considerations of its decision. *See also* Berman v. Aetna Casualty & Sur. Co., 40 Cal. App. 3d 908, 115 Cal. Rptr. 566 (1974). The court suggested that a lot owner that had completed improvements could intervene in a suit brought by the local government to recoup his costs of completion and to avoid a windfall to the government. *Id.* at 911, 115 Cal. Rptr. at 568. The court's suggestion, however, constitutes dictum because the court held that the plaintiff's suit was barred on res judicata grounds. *Id.* at 912, 115 Cal. Rptr. at 568. Apparently, the trial court in an earlier action had held that Berman could not intervene and he failed to appeal. *See id.* at 912, 115 Cal. Rptr. at 568.

2. Suits by Other Third Parties on the Guarantee

Laborers, materialmen, and subcontractors have faired no better in attempting to collect under a subdivision improvement guarantee. These parties have no right of action as third party beneficiaries of a performance bond[439] or a combined performance and payment bond when the major purpose of the bond is to secure performance.[440] Courts also have held that subcontractors are not entitled to collect under a letter of credit[441] and a cash escrow agreement.[442] The fact that the guarantee may contain language implying that third parties have a cause of action provides no help because the courts either construe the language narrowly[443] or hold that the government's action creating the right constitutes an ultra vires act.[444]

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439. Evola v. Wendt Constr. Co., 170 Cal. App. 2d 21, 25, 338 P.2d 498, 501 (1959). *See also* J.I. Newton Co. v. Martin Dev. Co., 193 So. 2d 464, 465 (Fla. Dist. Ct. App. 1967) (subcontractors are not entitled to reimbursement from defaulting contractor's performance bond).

440. Scales-Douwes Corp. v. Paulaura Realty Corp., 24 N.Y.2d 724, 726, 249 N.E.2d 760, 761, 301 N.Y.S.2d 980, 981 (1969) (holding that the paramount purpose of the subdivision improvement bond was to secure performance and not guarantee payment to suppliers).

441. Schmidt-Tiago Constr. Co. v. City of Colorado Springs, 633 Colo. App. 533, 534, 633 P.2d 533, 534 (1981).

442. Tom Morello Constr. Co. v. Bridgeport Fed. Sav. & Loan Ass'n, 280 Pa. Super. 329, 336, 421 A.2d 747, 751 (1980) (holding that the escrow agent was entitled to make payments to the developer rather than to the contractor).

443. Weber v. Pacific Indemn. Co., 204 Cal. App. 2d 334, 338, 22 Cal. Rptr. 366, 369 (1962).

444. W.S. Dickey Clay Mfg. Co. v. Ferguson Inv. Co., 388 P.2d 300, 304 (Okla. 1963) (holding that the planning authority had no power to require a condition in the performance bond that contractors, subcontractors, materialmen, and laborers should be paid). Local governments in fact, do have an incentive to ensure that all work on the improvements is paid for so that it does not accept the improvements subject to any liens or encumbrances. At least one court has suggested that the lienor can enforce its rights against the local government after it assumes control of the improvements. *See* Scales-Douwes Corp. v. Paulaura Realty Corp., 24 N.Y.2d 724, 727, 249 N.E.2d 760, 761, 301 N.Y.S.2d 980, 981 (1969).

The rule against a third party right of recovery sometimes leads to harsh results. *See* Ragghianti v. Sherwin, 196 Cal. App. 2d 345, 351, 16 Cal. Rptr. 583, 587 (1961). The rather complicated facts in *Ragghianti* arose when a housing contractor who was constructing homes in a subdivision failed to pay a street contractor. The title insurance company paid the street contractor's claim. The title insurance company subsequently brought an action against the owner of the property who had posted a performance bond with the local government. The owner, believing that he was liable to the third party under the bond, paid the claim and then sought reimbursement from the housing contractor. The court held that third parties had no claim under the bond. *Id.* at 351,

When a local government receives a cash escrow from a subdivider and the government rejects the subdivision proposal, one court has held that a judgment creditor can attach the subdivider's funds.[445] That result may mean that a local government should exercise extreme care when it returns any cash or a security deposit to a developer if a third party has attached the cash or security.[446]

3. Assignment of the Government's Right of Action

One of the strongest cases for permitting third parties to recover under a bond or other security occurs when the third party has completed subdivision improvements after the developer's default. The situation differs from a third party beneficiary's claim because the third party acquires the cause of action held by the government. *Morro Palisades Co. v. Hartfort Accident & Indemnity Co.*,[447] is a leading case often cited for the proposition that a third party cannot recover under an assignment of the government's cause of action following the developer's default. In *Morro*, however, the evidence did not reveal that the third party had ever completed the improvements or that it intended to do so.[448] The court recited the general rule that the performance bond runs in favor of the government and any action on the bond must be brought in the name of the government.[449]

Two courts confronted by an assignment of the government's cause of action have distinguished *Morro*.[450] In both cases the courts stressed the fact that the government made the assignments to fulfill

16 Cal. Rptr. at 587. The court further held that Ragghianti's payment was voluntary and, therefore, denied him a right to reimbursement from the defendant housing contractor. *Id.*

445. Cammarano v. Borough of Allendale, 65 N.J. Super. 240, 241, 167 A.2d 431, 432 (Ch. Div. 1961).

446. A local government should use an escrow agent so that it does not bear the risk of returning the deposit to the wrong person. Although the government can resort to interpleader, it will find itself in a lawsuit not of its own making. In fact, to constitute a true escrow, a third party would be required to hold funds or other collateral securing performance.

447. 52 Cal. 2d 397, 340 P.2d 628 (1959) (in bank).

448. *Id.* at 400, 340 P.2d at 628.

449. *Id.* at 401, 340 P.2d at 631. *See also* Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 519, 428 N.Y.S.2d 589, 593 (N.Y. Sup. Ct. 1980) (the court in dictum stated that an assignment of the government's right would be ineffective).

450. County of Will v. Woodhill Enters., Inc., 4 Ill. App. 3d 68, 75, 274 N.E.2d 476, 481-82 (1971); Clearwater Assocs., Inc. v. F.H. Bridge & Son, Contractors, 144 N.J. Super. 223, 226, 365 A.2d 200, 202 (App. Div. 1976).

the purposes of the performance bond—completion of subdivision improvements;[451] thus, the courts upheld the assignments.

4. Assignment of Bond Proceeds

To avoid the problem of failing to bring suit in the name of the government, several courts have considered whether a government may assign any proceeds that it obtains in exchange for the assignee's completion of the improvements. The courts are split on the authority of the government to make such an assignment.[452] On the one hand, one can argue that if the government can complete performance by employing a third party to construct the improvements, it should be able to assign bond proceeds to that party.[453] On the other hand, courts may perceive that the assignee, who usually has taken over completion of the development after a foreclosure or accepted a deed in lieu of foreclosure, should be required to complete the improvements or post bond just as any other developer must do.[454] When the purchaser of the development replats the property, denial of the assignment *may* be proper;[455] but, if the purchaser merely does what the original developer

451. For example, in *Clearwater Associates*, the assignee who was a 50% owner of the development property "expressly undertook to complete the improvements" and the improvements in fact, were completed at the time the assignee commenced the suit. 144 N.J. Super. at 228-29, 365 A.2d at 203.

452. *Compare* City of Sacramento v. Trans Pac. Indus., Inc., 98 Cal. App. 3d 389, 401, 159 Cal. Rptr. 514, 520 (1979) (upholding assignment) *and* Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 35, 245 S.E.2d 425, 429 (1978) (upholding assignment) *with* City of Ames v. Schill Builders, Inc., 292 N.W.2d 678, 682 (Iowa 1980) (invalidating assignment) *and* Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 519, 428 N.Y.S.2d 589, 592 (N.Y. Sup. Ct. 1980) (invalidating assignment).

453. *See, e.g.*, Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 34, 245 S.E.2d 425, 429 (1978) ("The assignment . . . was for the purpose of obtaining performance guaranteed by the bond. . . . [Since the work was performed], we perceive no reason for finding that the assignment was invalid.").

454. Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 519, 428 N.Y.S.2d 589, 593 (N.Y. Sup. Ct. 1950) ("Having become the owners of a parcel of real property, the bank found it . . . in its interest to subdivide the property . . . the bank, like any other developer, either had to intall improvements required . . . or ,post security. . . .").

455. City of Ames v. Schill Builders, Inc., 292 N.W.2d 678, 681 (Iowa 1980) (holding that the mortgagee that accepted a deed in lieu of foreclosure and then replatted property became a developer and was not entitled to an assignment of bond proceeds). In an earlier case, the Iowa Supreme Court had upheld an arrangement by which the mortgagee had lent the city funds in exchange for an assignment of bond proceeds. City of Ames v. Schill Builders, Inc., 274 N.W.2d 708, 712 (Iowa 1979). When the case came before the court the second time, the facts had changed. The mortgagee who had

was obligated to do, he should be able to receive the bond proceeds.[456]

5. Rights of Subsequent Developers Without Assignment

A similar problem occurs when a subsequent developer completes improvements that were the obligation of the first developer and then intervenes in the government's action against the developer.[457] In *Commonwealth ex rel. Pennsylvania Securities Commission v. Reliance Development Corp.*,[458] the Pennsylvania Superior Court held that the subsequent developer was entitled to recover from the cash escrow to recoup his cost of completing improvements that had been his predecessor's obligation. In *Hellam Township v. DiCicco*,[459] the court faced a similar situation only two years later, but in *DiCicco* it was unclear whether the subsequent developer would complete the improve-

become the owner of the property replatted a portion of the development and agreed to complete the improvements in exchange for an assignment of bond proceeds. The court held that this arrangement was invalid. 292 N.W.2d at 680-81.

456. *See* City of Sacramento v. Trans Pac. Indus., Inc., 98 Cal. App. 3d 389, 397, 159 Cal. Rptr. 514, 518 (1979). The court reasoned that a purchaser of lots in a financially troubled subdivision could take an assignment of bond proceeds in exchange for his completion of the improvements. *Id.* The court stated: "When [the] City entered into the agreement with Watkins . . . [the] City's damages did not magically disappear. Watkins did not promise to construct the improvements as a gift; he extracted consideration from the City in the form of [the] City's conditional promise to repay him if it prevailed in its action against defendants." *Id.* The court distinguished *Morro* on the grounds that the City had not alienated a "chose-in-action . . . it merely promised to pay Watkins for his work if it was successful in the lawsuit." *Id.* at 401, 159 Cal. Rptr. at 520.

457. The action may have been brought on behalf of the developer if the security was a cash escrow. The developer or one claiming through him would seek a return of the security.

458. 258 Pa. Super. 276, 283, 392 A.2d 792, 795 (1978). The facts in *Reliance* are indicative of development problems. The original developer became insolvent after selling only one lot in his subdivision. The property was sold at a sheriff's sale and the developer went into receivership. The receiver brought an action to recover the cash escrow put up by the developer. The local government interpleaded the purchaser at the sheriff's sale who had completed the improvements and the trial court held for the government. *Id.* at 279, 392 A.2d at 793. On appeal, the government, which had disavowed any claim to the money, failed to file a brief in support of itself. *Id.* at 280, 392 A.2d at 794. The appellate court determined that the purchaser of the property was entitled to reimbursement, but only for improvements that were the obligation of the original developer. *Id.* at 283, 392 A.2d at 795. Because the original developer was obligated only to complete improvements for lots that were sold, the purchaser's recovery was minimal. *Id.* at 283, 392 A.2d at 795.

459. 287 Pa. Super. 227, 429 A.2d 1183 (1981).

ments.[460] Thus, the court held that the surety could not reopen a confessed judgment on the ground that the township would be unjustly enriched if the subsequent developer completed the improvements.[461] In fact, the court hinted that the surety might be unable to reopen the judgment even if the subsequent developer completed the improvements so that the original developer who had been obligated to complete the improvements would not be unjustly enriched.[462]

The problems created when a subsequent developer completes improvements is not subject to easy resolution. The subsequent developer is not a successor in interest because the original developer has not sold his business; rather, the subsequent developer is often a mortgagee who has foreclosed or accepted a deed in lieu of foreclosure, a purchaser at a foreclosure sale, or a purchaser of lots in the subdivision. Disregarding the entry of these persons, it is clear that the government will be entitled to collect under the security agreement after default by the developer. The measure of damages will be the cost of completion.[463] Thus, the issue is whether the measure of damages should be less when a subsequent developer completes the improvements for which the original developer was responsible. Arguably, the subsequent developer only should recover to the extent the original developer sold lots that incorporated the cost of the uncompleted improvements, thus, avoiding unjust enrichment to the original developer. A contrary resolution presumably will result in unjust enrichment to the subsequent developer if he incorporates the cost of improvements into lots or homes and then receives security proceeds. The key term is "unjust." If the original developer can avoid his obligation to the government so easily, he may readily transfer the property to another once the development begins to sour. Then, after another party completes the improvements, the original developer can claim unjust enrichment.[464]

On strictly legal grounds, the original developer and the surety might have the better argument. On policy grounds, however, it can be argued that permitting a subsequent developer to claim bond proceeds or other security will facilitate completion of the development and the

460. *Id.* at 231, 429 A.2d at 1185.

461. *Id.* at 232, 429 A.2d at 1186.

462. *Id.* at 232, 429 A.2d at 1185-86.

463. *See* Board of Supervisors v. Ecology One, Inc., 219 Va. 29, 35, 245 S.E.2d 425, 429 (1978).

464. *See* Hellam Township v. DiCicco, 287 Pa. Super. 227, 232, 429 A.2d 1183, 1185-86 (1981) (court expresses this concern).

improvements for which the government had bargained. A subsequent developer will be difficult to locate if he is faced with completing thousands or hundreds of thousands of dollars in improvements. Even if the subsequent developer makes significant modifications in the development to promote the project's viability, he should be entitled to the bond proceeds or other security to the extent of the original developer's liability.[465]

E. *Developer and Surety Defenses*

A wide array of defenses is available to the developer and his surety in an action on the bond or other security. First, under principles of suretyship, all defenses available to the principal-developer also are available to the surety. Second, the surety has additional defenses when the underlying agreement between the developer and the local government is modified materially without the consent of the surety. This section examines the defenses interposed by developers and sureties, revealing the extent to which the surety will litigate to avoid his apparent obligation.

1. Statute of Limitations

A developer and his surety might escape liability for completing subdivision improvements if the government brings an action beyond the limitations period for actions on improvement bonds. Because of a poorly drafted local ordinance, the Oklahoma Supreme Court discussed that state's limitations period on two occasions.[466] In *Sherwood*

465. It is curious that in at least two cases, the lender on the development sought to collect bond proceeds. City of Ames v. Schill Builders, Inc., 292 N.W.2d 678 (Iowa 1980); Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 428 N.Y.S.2d 589 (N.Y. Sup. Ct. 1980). Typically, a lender agrees to indemnify the surety if the developer defaults and the lender secures himself with a mortgage on the development property. Thus, if the surety pays a claim on the bond, the lender will indemnify the surety. The lender then will attempt to recover from the developer, hoping that the value of the property is sufficient to satisfy his claims. When the developer's lender also is the surety or guarantor on a project, the lender will have an incentive to complete the improvements after a default by the developer because completion will enhance the value of the property, which the lender probably will sell after he purchases at the foreclosure sale or accepts a deed in lieu of foreclosure. The developer is ultimately responsible for any expenditures made for improvements, but if he is insolvent, the lender should recoup his costs when he sells the property.

466. Sherwood Forest No. 2 Corp. v. City of Norman, 632 P.2d 368, 370 (Okla. 1980); City of Norman v. Liddell, 596 P.2d 879, 881-82 (Okla. 1979). *See infra* notes 467-71 and accompanying text.

Forest No. 2 Corp. v. City of Norman,[467] the court held that the local government could not by ordinance or contract set a shorter period of limitations than that provided by state law.[468] Thus, the court struck down the two year period within which to bring an action on the bond and applied the state's five year period for actions on written contracts.[469] Moreover, the five year period began to run at the end of the two year bond period.[470] In *City of New Orleans v. Mark C. Smith & Sons, Inc.*,[471] the Louisiana Supreme Court explained that performance bonds and subdivision improvement agreements did not constitute public works projects; therefore a short three year period of limitations did not apply.

2. Release and Acceptance

Typically, when the local government accepts a dedication of the subdivision improvements, the developer's performance is complete and he and any surety then should be released. Similarly, one may expect that if the government releases the performance bond, it no longer intends to hold the developer responsible for maintenance of the improvements. Things are never as simple as they seem. Courts have held that a recordation of deeds to improvements and easements does not constitute a formal acceptance of a dedication thereby releasing the bond because the government may only have been guaranteeing itself access to the property in case of default.[472] Conversely, a release of a bond does not equal acceptance of improvements and the developer's obligation to maintain the improvements continues.[473] Acceptance of a dedication is a legislative act that requires an indication that the government intends to exercise "dominion and control" over the dedicated property.[474]

State statutes and local ordinances often provide time periods within

467. 632 P.2d 368 (Okla. 1980).

468. *Id.* at 370.

469. *Id.*

470. *Id.*

471. 339 So. 2d 321, 322 (La. 1976).

472. Anne Arundel County v. Lichtenberg, 263 Md. 398, 406-07, 283 A.2d 782, 786-87 (1971). *See also* Lichtenberg v. Anne Arundel County, 258 Md. 204, 209-11, 265 A.2d 222, 225 (1970) (same issue after remand to trial court).

473. Home Builders League of S. Jersey, Inc. v. Township of Evesham, 182 N.J. Super. 357, 360-61, 440 A.2d 1361, 1363-64 (App. Div. 1981).

474. *Id.* at 361, 440 A.2d at 1364. *See also* County of Kern v. Edgemont Dev. Corp., 222 Cal. App. 2d 874, 879-80, 35 Cal. Rptr. 629, 632 (1963) (developer not

which the government must act on the developer's offer to dedicate improvements. The failure to act constitutes an acceptance and releases the developer of any further obligation, and the government should release any bond or other security to him.[475] One court, however, in a wholly unacceptable opinion, held that failure of the government to act within the specified time period did not constitute an acceptance if the improvements were in any way defective,[476] thus frustrating any purpose that the provision may have had.

3. Exoneration

A surety may claim exoneration—that is, release from its obligation—for a variety of reasons, but the surety most commonly claims that the underlying agreement between the developer and the government has been modified materially. Because a material modification may increase the risk to the surety, courts generally hold that such circumstances will exonerate the surety. The surety, however, may waive his right to claim exoneration when the bond permits the obligation of the developer to be modified without consent of the surety.[477] Moreover, if the modification is not material, the surety will not be discharged.[478] In one of the more unusual claims for exoneration,[479] a surety asserted that after the government completed improvements in a development, the government obtained an equitable lien against the property. Therefore, the surety argued the city must look to the prop-

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exonerated when he completed improvements; developer exonerated only after acceptance, which is a discretionary act of local government).

475. *See* Mertz v. Lakatos, 33 Pa. Commw. 230, 236, 381 A.2d 497, 500 (1978) (failure of the government to act within the time period constituted acceptance of roads and cash escrow released).

476. Township of Barnegat v. DCA of N.J., Inc., 181 N.J. Super. 394, 400-01, 437 A.2d 909, 912 (App. Div. 1981). The court reasoned that the statute required the local government to act on the offer to dedicate within 45 days after the developer gave notice that the improvements were complete or substantially complete. *Id.* Thus, if the improvements were not, in fact, complete or substantially complete, the government had no obligation to act within the requisite time period. *Id.* This reading of the statute frustrates the very purpose for which the state enacts such a provision.

477. Pacific County v. Sherwood Pac., Inc., 17 Wash. App. 790, 800, 567 P.2d 642, 649-50 (1977).

478. *Id.* at 800, 567 P.2d at 649. The courts appear to construe bonds strictly against the surety, which is interesting in light of the fact that the local government often drafts the bond. Such bonds generally recite a waiver of the surety's right to consent to material modifications in the obligation of the developer.

479. Corn Constr. Co. v. Aetna Casualty & Sur. Co., 295 F.2d 685, 689-70 (10th Cir. 1961).

erty of the principal on the bond.[480] The court rejected the surety's twisted logic, noting that no equitable lien was created and that the city's right was on the bond.[481]

The developer's obligation may be enlarged because of unforeseen additional burdens that occur during construction of improvements. If the developer is aware of an unusual condition that causes the performance of extra work, this knowledge will be imputed to the surety who is called on to complete the improvements; the surety cannot reform the bond on the grounds of unilateral mistake.[482] When the city, however, is obligated to undertake certain improvements as a condition precedent to the developer's duty to improve roads, neither the developer nor the surety is liable when the city fails to perform its purported obligations.[483]

4. The Developer's Bankruptcy

The obvious reason for a performance bond or other security is to secure the government against a default on the developer's promise to construct improvements. Because default often is related to financial difficulty, however, the developer's bankruptcy will threaten the government's security. Although bankruptcy law is still in an evolutionary stage, several courts have dealt with the impact of the developer's bankruptcy on the government's security. One court has held that the government may maintain an action against the surety of a bankrupt developer even though the developer indemnified the surety against any loss.[484] In contrast, another court held that the automatic stay

480. *Id.*

481. *Id.* at 689. The surety also claimed a right of subrogation on the purported equitable lien. *Id.* at 690. Thus, it was unnecessary to pay the city's claim because the surety simply would be subrogated to the lien that the city already possessed. *Id.* One only can suspect that the surety was not adequately secured against its potential liability.

482. *See* City of Cypress v. New Amsterdam Casualty Co., 259 Cal. App. 2d 219, 224-25, 66 Cal. Rptr. 357, 360 (1968).

483. City of Medford v. Fellsmere Realty Co., 345 Mass. 477, 482, 187 N.E.2d 849, 851-52 (1963). In fact, the planning board had no authority to require improvements by the city, but because the parties had agreed that the developer's obligation would not arise until performance by the city, the court discharged the developer and the surety when the city failed to perform. *Id.* at 481, 187 N.E.2d at 851-52.

484. *In re* Staindco Developers, Inc., 534 F.2d 1050, 1053-54 (2d Cir. 1976). The court also held that a payment by the surety would not constitute a preferential payment to the government. *Id.* at 1054-55. *But see In re* Joe DeLiski Fruit Co., 11 B.R. 694, 696 (D. Minn. Bankr. 1981) (the court held that the automatic stay provisions of

provisions of the bankruptcy code prevent the government from maintaining an action against a cash escrow that secured the developer's promise to complete improvements.[485] Although the automatic stay provisions exempt government actions to enforce health and safety regulations,[486] courts hold that collection of proceeds under a security agreement does not come within the scope of the exemption.[487]

When the bankrupt developer attempts to reorganize or liquidate his business, the bankruptcy courts may enjoin state and local government actions that will impede the debtor's efforts. Thus, one court held that the bankruptcy court can order a local government to refrain from applying ordinances adopted after preliminary plat approval even though the developer has not filed a final plat within the time allotted by law.[488] The court reasoned that the developer acquired vested rights that could not be denied.[489]

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the Bankruptcy Code, 11 U.S.C. § 362(a)(1) (1982), protected a letter of credit posted in lieu of a payment bond by a wholesaler).

485. *In re* Heckler Land Dev. Corp., 15 B.R. 856, 859 (E.D. Pa. Bankr. 1981) (holding that the cash escrow was property of the debtor's estate protected by the automatic stay provisions). *But see* Brilliant v. Harvey Constr. Co., 212 F.2d 494 (9th Cir. 1954). The court held that the cash deposit to secure performance of the developer's completion of improvements was not property of the debtor's estate, and, therefore, the trustee in bankruptcy could not reach the property. *Id.* at 495. Because of sweeping changes in the bankruptcy law since *Brilliant*, its continuing vitality is suspect.

486. *See* 11 U.S.C. § 362(b)(4) (1982).

487. *In re* Heckler Land Dev. Corp. 15 B.R. 856, 858 (E.D. Pa. Bankr. 1981). *See also In re* Joe Deliski Fruit Co., 11 B.R. 694, 696-97 (D. Minn. Bankr. 1981) (exemption did not apply to collection under payment bond). The *Heckler* court distinguished *In re* Stanndco Developers, Inc., 534 F.2d 1050, 1053-54 (2d Cir. 1976), where the court had held that an action on a surety bond was not within the automatic stay provisions of the Bankruptcy Code. 15 B.R. at 858-59. The *Hechler* court reasoned that a surety bond involved third party liability, while collection under a cash escrow involved the debtor himself. *Id.* at 858-59. If, as in *Stanndco*, the developer has agreed to indemnify the surety, payment on the bond does create an indebtedness for the bankrupt debtor.

488. *See* San Clemente Estates v. City of San Clemente, 12 B.R. 209, 217 (S.D. Cal. Bankr. 1981).

489. *Id.* at 216-17. In truth, the court believed that application of the new ordinances would diminish the financial prospects of the debtor's reorganization. *See id.* at 211-15. The court's analysis of the vested rights issue is subject to serious doubt. *See* Slagle Constr. Co. v. County of Contra Costa, 67 Cal. App. 3d 559, 563-64, 136 Cal. Rptr. 748, 750-51 (1970) (the court held that the developer could not sue the county for failure to issue building permits after final plat approval because the developer refused to bury certain utility lines).

F. *Developer Remedies Against the Government*

Often a developer will comply with the local government's initial demands because he knows that he will be dependent on the cooperation of the government for the ultimate success of the development. Even short delays can cause the development to founder. Thus, the issue arises regarding the right of the developer to challenge subdivision improvement requirements or other exactions after he fails to object to the requirements during the approval process.

One line of cases holds that a developer can recover excessive payments that the government forced him to make, but which he failed to challenge during the approval process.[490] The theory allowing recovery is that the developer made payment or dedicated land under economic duress.[491] In contrast, one court has held that the developer cannot maintain an action against the local government on the basis of excessive off-site improvement requirements when the developer failed to pursue his administrative remedies.[492] The courts' murkey rationale is based on a combination of governmental immunity and exhaustion of remedies principles.[493]

G. *Summary*

The 1970s and early 1980s have witnessed an explosion in case law concerning subdivision improvement requirements and guarantees. The litigious nature of developers and their sureties is related closely to economic conditions. When times are good, developers will accept requirements and merely pass the cost along to lot and homebuyers. When times are adverse, developers will be more careful about what they perceive to be unnecessary costs. Similarly, government actions to

490. *See* Ridgemont Dev. Co. v. City of E. Detroit, 358 Mich. 387, 393-94, 100 N.W.2d 301, 304-05 (1960) (developers entitled to reconveyance of property dedicated to the government under duress); Divan Builders, Inc. v. Planning Bd., 66 N.J. 582, 603-04, 334 A.2d 30, 41 (1975) (developer entitled to recover excessive payments for off-site improvements made under duress); Lake Intervale Homes, Inc. v. Township of Parsippany-Troy Hills, 28 N.J. 423, 430-31, 147 A.2d 28, 33 (1958) (developer entitled to recover excessive costs for extension of water mains).

491. *See, e.g.*, Ridgemont Dev. Co. v. City of E. Detroit, 358 Mich. 387, 393-94, 100 N.W.2d 301, 304 (1960) (allowing recovery of dedicated lands).

492. Northwest Land & Inv., Inc. v. City of Bellingham, 31 Wash. App. 742, 744-45, 644 P.2d 740, 741 (1982).

493. *Id.* A Washington statute that limited the standard of review for subdivision approval and the time limit in which challenges could be made supported the court's opinion. *Id.* at 743 n.1, 644 P.2d at 741 n.1.

enforce bonds and other security agreements should correlate with economic conditions because defaults are more likely during economic downturns. At any rate, the courts have been and will continue to be faced with a great array of issues concerning subdivision improvements. While the courts will resolve some of these issues on statutory grounds and basic contract law principles, many courts will analyze closely the government's power to burden the developer with the cost of providing public improvements.

V. EVALUATING SUBDIVISION IMPROVEMENT GUARANTEES

An evaluation of subdivision improvement guarantees presents two major problems: first, a viewpoint must be taken from which guarantees can be evaluated; second, an evaluation is difficult because of the variety of methods by which developers structure their financial arrangements.[494] The evaluation here is presented from the local government's viewpoint because it is assumed that the government's interest is allied most closely with the purpose of the guarantee—the completion of improvements.[495] The evaluation does not consider every financial arrangement adopted under each security method; rather, the evaluation focuses on how to avoid the problems that can plague the guarantee process. The conclusion reached can be stated at the outset: the corporate surety bond is not the most effective method for securing the completion of subdivision improvements. Effectiveness is based on a consideration of four factors: security to the government; flexibility; cost; and retention of control by the government over the security.

A. *Government Security*

1. Access to Sufficient Funds

Local governments impose subdivision improvement requirements for a variety of reasons, but the requirement that the developer post security to assure completion of improvements is designed only to protect the government from completing improvements at its own expense. Thus, the effectiveness of any security method turns on the

494. *See supra* notes 222-331 and accompanying text.

495. *See* R. FREILICH & P. LEVI *supra* note 1, at 103 (major purposes of bonds are to protect health and welfare of subdivision residents and to reduce financial burden on municipalities). Although the improvement guarantees protect the interests of neighbors and lot owners, these persons have not been considered proper parties to enforce obligations under the bonds. *See* R. YEARWOOD, *supra* note 1, at 139.

extent to which the government can obtain sufficient funds to complete improvements after the developer defaults. Because financial problems generally trigger the developer's default, it can be assumed that the government's sole source for recovery is the security itself.

Property and cash escrows do not provide the assurance of adequate funds. Property escrows in general present the problem of valuation, and the government must hope that the property, whether real or personal, tangible or intangible, is convertible into sufficient cash to fund completion of improvements.[496] Liens also can encumber real property escrows. These liens generally will take priority over the government's claim. The cash escrow presents the problem of accountability. Generally, escrowed funds are released as improvements are completed—thus creating two problems: whether the developer actually completed the improvements and whether the developer used the released funds to pay off materialmen and laborers. Ideally, these questions are answered affirmatively, but the world of subdivision development seldom is ideal. Corporate surety bonds also present problems because recovery on the bond is limited to its face amount.[497] Although the developer will be independently liable on any underlying contract for completion of improvements,[498] the developer probably will be judgment proof. The local government must assure itself that the face amount of the bond is sufficient to complete improvements. A guarantee or letter of credit by a surety, usually the lender on the project, does not create the problems of property or cash escrows. Maximum liability limits under these security methods, however, can result in the government receiving inadequate funds with which to complete improvements. The message to the local government is that all security methods pose the danger of providing insufficient funds if the government accepts inadequate security or releases the security prematurely. Subjecting errant officials to liability for their negligence may provide an incentive to avoid these problems.

2. Defenses to the Government's Claims

When the developer provides security to guarantee completion, the

496. For example, if the government accepted securities at the time of final plat approval, the value of the securities can decline significantly at the end of the two year completion period. Meanwhile, the cost of completion probably has increased.

497. *See* B. ROGAL, *supra* note 12, at 3.

498. *See* Town of Brookfield v. Greenridge, Inc., 177 Conn. 527, 536-37, 418 A.2d 907, 912-13 (1979).

government must face only the defenses that the developer can raise against an alleged default. When the government requires the developer to post a corporate surety bond, the surety can interpose all defenses available to the developer, plus several of his own. The corporate surety has an incentive to avoid paying a claim to the government: the surety may be unable to collect on an indemnification agreement that the surety may have with the developer either because the developer has a legitimate defense or the developer is insolvent. Consequently, claims against the surety often result in litigation.

Security arrangements by which the developer's lender assures completion are more promising. The lender has an incentive to complete improvements if it is forced to foreclose on its lien against the development property. Because the lender will be more likely to find a buyer for the development if improvements are completed, the lender can recoup its cost in the selling price of the development. Thus, guarantees or letters of credit issued by the lender are superior to cash, property escrows, and corporate surety bonds.

The continuing reliance on corporate surety bonds by many local governments[499] is attributable to statutory requirements in only a few jurisdictions. Most states and local governments permit other security methods to assure completion of improvements. Although a guarantee or letter of credit might not fit within the traditional scope of subdivision improvement guarantees,[500] each method assures completion of improvements and should be permitted by the courts.

3. Avoiding the Risk of the Developer's Bankruptcy

Given the state of flux in bankruptcy law, it is difficult to make any definitive statement about how the courts may apply the law to a particular set of facts. The problem, however, is relatively straightforward: if the developer seeks the cover of bankruptcy laws, is the government's action after default barred by the automatic stay provisions of federal law,[501] and will a developer's, or surety's payment constitute a preferential payment in violation of the law?[502] The sparse case law on point suggests that the automatic stay provisions will bar

499. *See* S. SEIDEL, *supra* note 1, at 136. Of cities responding to survey, 96.2% reported that they accepted a corporate surety bond. *Id.* The letter of credit was the least used security method. *Id.*

500. *See* McPherson, *supra* note 32, at 465-66.

501. *See* 11 U.S.C. § 362 (1982).

502. *See id.* § 547.

the government's claim against a developer in bankruptcy when the security is a property or cash escrow or something else of value pledged by the developer himself. The bar probably will not apply when the government's claim is against some third party such as a corporate surety or a coguarantor. Because the surety or coguarantor is likely to have an indemnification agreement with the developer, however, any payment by the third party affects the financial status of the debtor-developer. Consequently, a bankruptcy court retains the power to stay an action by the government against a third party if the debtor's estate ultimately is at risk.[503]

Payment of a claim out of escrowed cash or property or payment of a claim by a coguarantor or a surety can be viewed as a preferential payment in violation of the bankruptcy law. A preferential payment arises when a debtor makes a payment to a creditor within ninety days of filing bankruptcy and the transfer permits the creditor to obtain more than he would have received from a liquidating bankruptcy if the payment had not been made.[504] The purpose of permitting the trustee in bankruptcy to void preferential payments is to ensure that all similarly situated creditors are treated alike. Thus, a trustee may set aside a payment to a local government when the government obtains payment within the criteria established for preferential treatment. The issue is not as clear when the payment is made by a third party that the debtor-developer will indemnify. Besides being a possible preferential payment, a coguarantor or surety can use a third party payment prior to the developer's bankruptcy as a device to ensure that their security is not exhausted before they are required to pay a claim presented by the government.[505]

At best, the potential problems that the new bankruptcy laws create can be raised so that parties to subdivision improvement guarantees will be able to devise imaginative schemes to avoid the effect of the law.

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503. *See id.* § 541(a)(1) (defining the debtor's property); Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-For-Lawyers Bill Part III: Business Bankruptcy*, 1979 UTAH L. REV. 405, 416-29 (discussing the property of the debtor's estate).

504. *See* Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-For-Lawyers Bill Part IV: Avoiding Powers of the Trustee*, 1980 UTAH L. REV. 19, 38-44. *See also* 11 U.S.C. § 547(b) (1982).

505. A secured surety may fear that it may have to pay a claim after the debtor's bankruptcy because the security may be exhausted by others when disbursements are made. Thus, the surety has an incentive to pay a claim before bankruptcy to ensure that he will be repaid, at least in part, out of his security. *See* Aaron, *supra* note 503, at 454-66 (distributing the assets of the debtor's estate).

Nevertheless, because bankruptcy law is equitable in nature, the courts probably will look past a transaction's form to its substance.[506]

B. *Flexibility*

Modern subdivision guarantees must account for the complex financial transactions that often occur after the developer's default. Because the developer's default is often, if not always, motivated by financial problems, it is probable that some creditors will foreclose their interest in the development property. Thus, the lender, a purchaser at a foreclosure sale, or a purchaser of lots in the subdivision might desire to complete improvements in the subdivision in order to increase the value of their investment.

The courts are divided on the right of a subsequent developer to claim proceeds from an improvement guarantee. Two courts have held that the subsequent developer should be held to the same requirements of the original developer, particularly if the subsequent developer modifies the subdivision project.[507] On the other hand, several courts have permitted a subsequent developer to collect under a subdivision guarantee when the subsequent developer completed improvements for which the original developer was obligated.[508] These courts reasoned that the government was entitled to collect under the guarantee for the purpose of completing improvements; therefore the government could authorize the subsequent developer to complete improvements in exchange for any proceeds that the government could collect.[509] As previously noted, the issue is best resolved with reference to the purpose of the guarantee: to assure a complete development free from the harmful consequences of partial subdivision. Thus, development of the subdivision is facilitated when a subsequent developer can obtain funds from the improvement guarantee. This financial incentive might be necessary to ensure that the partially completed development does not constitute a burden to the community.

The subsequent developer problem should arise only when the devel-

506. *See* Aaron, *supra* note 504, at 38.

507. *See* City of Ames v. Schill Builders, Inc., 292 N.W.2d 678, 681 (Iowa 1980); Village of Warwick v. Republic Ins. Co., 104 Misc. 2d 514, 518, 428 N.Y.S.2d 589, 593 (N.Y. Sup. Ct. 1980).

508. *See, e.g.*, City of Sacramento v. Trans Pac. Indus., Inc., 98 Cal. App. 3d 389, 401, 159 Cal. Rptr. 514, 520 (1979) (permitting assignment of proceeds to subsequent developer).

509. *See id.*

oper himself or a third party guarantees completion of the improvements.[510] Each party is opposed to paying a claim that will increase the value of property that neither owns. In contrast, if the lender on the project secures performance by a guarantee or letter of credit, the lender will have an incentive to complete the improvements in the event that it forecloses its lien against the property. Although the lender's security interest in the developer's property may be insufficient to compensate the lender, the lender can recoup its expenses when it sells the improved property to someone that actually develops property.

When a party other than the developer or the lender secures performance, the government should consider naming the lender as an obligee under the bond or other security. Although several courts have held that it was ultra vires for the government to name certain third parties as beneficiaries under a bond,[511] this proposition should not apply when the sole purpose of naming multiple obligees is to guarantee completion of the improvements. The government's power to name multiple obligees for the limited purpose of assuring completion is reasonably necessary and should be implied from the subdivision control law.[512]

C. *Costs*

1. Direct Costs

Subdivision improvement guarantees inherently increase the costs of the development project. Cash and property escrows tie up the developer's capital without any economic return. Lenders also exact some premium from the developer for securing completion of improvements. Costs are especially burdensome when the government requires a corporate surety bond. Not only must the developer pay a premium for the bond, but also he or his lender must promise to indemnify the surety in the event that the surety makes payment on a valid claim. Thus, it is unclear why a corporate surety is necessary if the developer or his lender must secure the surety on the indemnification agreement.

510. None of the reported cases involve a situation when the lender secured completion of the improvements.

511. *See* Gordon v. Robinson Homes, Inc., 342 Mass. 529, 531, 174 N.E.2d 381, 382-83 (1961).

512. *See, e.g.*, Legion Manor, Inc. v. Township of Wayne, 49 N.J. 420, 424-25, 231 A.2d 201, 203-04 (1967) (implying a right to require a maintenance bond).

The security more easily and less expensively can run directly from the developer or lender to the government.

2. Indirect Costs

Housing costs are related to the structure of the housing market which, in turn, is affected by subdivision improvement guarantees. At least anecdotal evidence suggests that a corporate surety bond favors a large, financially stable developer that can qualify for the bond.[513] Similarly, a cash escrow favors the more financially sound developer that can obtain sufficient cash to secure performance. Finally, a lender will not secure the completion of improvements unless it believes that the developer is a good credit risk.

Two alternatives to subdivision guarantees are government completion followed by an assessment of the benefited property and sequential approval. Government completion is risky because it requires a capital outlay by the government with no assurance that the development ever will be populated.[514] Sequential approval provides no guarantee at all, and if the developer walks away from the project, the government is left without funds to complete improvements.[515]

Again, local governments must make a public policy choice. Stringent improvement guarantees will work, though perhaps imperfectly, to screen out developers that are likely to fail to complete the proposed subdivision. Such guarantees also screen out developers that will complete and whose presence in the market serves as a competitive force driving down prices and improving overall quality. A proper balance must be struck between the government's interest in completing improvements and the public's interest in holding down costs. Local governments should consider a variety of security methods that can be fashioned to the needs of the individual developer while also adequately protecting the government. Exclusive reliance on corporate surety bonds does not strike that balance.[516]

513. *See* B. ROGAL, *supra* note 12, at 3.

514. *See id.* at 8-9.

515. *See* S. SEIDEL, *supra* note 1, at 136.

516. Better empirical data are needed to assess the effect of security methods on developers. Commentators assert too many conclusions without a firm empirical basis. *See, e.g.*, B. ROGAL, *supra* note 12, at 5-11 (offering extremely conclusory advice with little or no empirical support).

D. *Government Control Over the Security*

The control issue is important because it presents another tension in the guarantee process: the need for the government to control the security and to avoid its depletion for purposes other than completing improvements, and the need of citizens, neighbors, or lot owners to force a reluctant government to exercise its rights under a security agreement.

The courts are nearly unanimous in holding that third parties such as materialmen, laborers, neighbors, or lot owners cannot collect under a performance guarantee.[517] Most of these cases, however, went to the purpose of the bond rather than to the right of third parties to obtain performance.[518] Third parties usually brought suit to collect payment for completed improvements or to collect damages from inadequate or nonexistent improvements.[519] One unfortunate holding permitted a judgment creditor of the developer to attach a cash escrow being held for the government on the theory that the subdivision was not approved and that the cash belonged to the developer.[520] This holding places the government at risk whenever it holds cash or property because it may be confronted with conflicting demands for the funds. Thus, a government should avoid holding cash or other property to secure completion of improvements.

Persons with a legitimate stake in the completion of improvements, usually neighbors or lot owners, should have a means by which they can force the government to exercise its rights under the security agreement. Mandamus is one method that interested persons may use to compel the local government to assert a claim under the security agreement. Mandamus is available when the government has a nondiscretionary duty to perform and some person has an indisputable right to enforce that duty.[521] A statutory right to force government action should present no problem to a court, but a common law right of a neighbor or lot owner should exist to force the government to exercise its legal rights after the developer's default.

Statutory reform can secure more effectively the right of a neighbor

517. *See supra* notes 429-65 and accompanying text.

518. *Id.*

519. *Id.*

520. *See* Cammarano v. Borough of Allendale, 65 N.J. Super. 240, 241, 167 A.2d 431, 432 (Ch. Div. 1961).

521. *See* 4 R. ANDERSON, *supra* note 5, § 26.01; D. MANDELKER, D. NETSCH, & P. SALSICH, *supra* note 342, at 767-75.

or lot owner to force completion of improvements when the government is not vigilant in enforcing its rights. By statute, the legislature can give the local government a certain period of time within which to bring suit; after that time, the aggrieved citizen can bring suit on behalf of the government. The government can be made a party to the suit and can show good cause for not bringing suit against the developer or his surety.

E. *Summary*

The extent to which local governments use various subdivision improvement guarantees is not known with any degree of accuracy. The available evidence suggests that corporate surety bonds are the prevailing security method,[522] but that other more innovative methods are being used.[523] For a variety of reasons, corporate surety bonds do not adequately serve the needs of the government, developers, neighbors, or lot owners. Guarantees or agreements by which the development lender assures completion are potentially more likely to serve the purpose for which governments require security—to secure the completion of improvements.

VI. CONCLUSION

Residential subdivision is a complicated process that involves a variety of persons and government agencies, each with its own interests. Government regulation of the development process necessarily impinges on these interests and has the potential for creating unwanted side effects. The original purpose of subdivision improvement requirements continues in importance, but the methods to secure completion of improvements change continually. This Article has examined the complexity of the subdivision process and the wealth of issues raised by improvement requirements and guarantees. Although it cannot provide ready answers for developers, lenders, local governments, or aggrieved homeowners, the Article, hopefully, points out the many problems that arise and some methods by which these problems may be avoided.

522. *See supra* note 222 and accompanying text.

523. *See supra* notes 271-331 and accompanying text.