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ARTICLE**WILL KOONTZ MEAN BIG CHANGES OR BUSINESS AS USUAL
FOR REAL ESTATE DEVELOPMENT IN CALIFORNIA?**

By George B. Speir*

On June 25, 2013, the U.S. Supreme Court released its decision in *Koontz v. St. John's River Water Management District*.¹ *Koontz* has been called the most significant takings case since *Kelo v. City of New London*² and has been hailed by property rights advocates as a major victory for property owners. Writing for the 5-4 majority, Justice Alito wrote that property owners cannot be compelled to agree to an over-reaching demand by a public agency in order to obtain approval for a project. All the justices, including the four dissenting justices, agreed that refusing to grant a development permit unless a property owner agreed to an unconstitutional condition was no different from granting the development permit on the condition that the over-reaching government demand was later satisfied. This holding was not terribly controversial. An extortionate demand by a government agency is not different if it is phrased "if you agree to this condition, then the permit is granted" than if it is phrased "the permit is granted, but only if this condition is later satisfied."

The second proposition decided by the Court was more controversial. The Court held that monetary exactions must satisfy the same "essential nexus"³ and "rough proportionality"⁴ standards as government

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demands for dedications of property. The majority held that whether a property owner is required to dedicate land, or make an *in lieu* monetary payment of the same value, the impacts are the same. Either exaction must pass the *Nollan/Dolan* standards. The four dissenting justices took issue with this holding.

In California, *in lieu* fees and similar monetary exactions calculated for and imposed upon a specific development project have been analyzed under the *Nollan/Dolan* standards for many years, although this is not the case in some other states.

So what is the issue in California? The primary issue is how the decision will affect the calculation and enforcement of development impact fees. As outlined below, the Court's specific holding, based upon its facts, may change the legal analysis applicable to monetary exactions in some cases, but ultimately will not lead to any significant change for real estate development in California.

In 1996, a greatly divided California Supreme Court issued its decision in *Ehrlich v. City of Culver City*.⁵ The Court's holding in *Ehrlich*, reiterated in *San Remo Hotel v. City and County of San Francisco*,⁶ was that, while a monetary exaction imposed on a specific project on an individualized basis is subject to the heightened scrutiny of *Nollan/Dolan*, legislatively adopted development impact fees of general application to a large class of property owners were subject to a lesser and more deferential standard of judicial review. Does California's lesser judicial standard, simply requiring a reasonable relationship between a fee and a project, remain valid in light of the Supreme Court's decision in *Koontz*? Will development impact fee schedules adopted by virtually every city and county in California now be subject to judicial review when a city seeks to impose its fee schedule against an applicant under circumstances where the property owner believes the fee is excessive? Although California development impact fees were not specifically discussed by the dissent in *Koontz*, it was just this type of situation that Justice Kagan had in mind in objecting to applying any heightened scrutiny to monetary exactions.

THE HOLDING IN KOONTZ

Coy Koontz owned an undeveloped 14.9-acre tract of Florida land. The property was located in a designated wetland area, and consistent with Florida law, Koontz sought permits from respondent St. John's River Water Management District ("District") to permit the development of a 3.7-acre northern portion of his property. Koontz offered to mitigate the

environmental impact of the development by providing the District with a conservation easement over the approximately 11-acre southern portion of the land. The District considered the 11-acre conservation easement to be inadequate. It stated that it would approve the project only if Koontz agreed to one of two alternate proposals: (1) reduce the size of the development to one acre and provide the District with the conservation easement over the remaining 13.9 acres; or (2) develop the 3.7-acre northern portion of the property as proposed, deed a conservation easement to the District on the balance of the property and also agree to pay for improvements to District-owned land located several miles away. The District also said it would consider equivalent alternatives to its proposed offsite mitigation. Koontz declined to accept either of these proposed alternatives, believing them to be excessive in light of the environmental effects that his project would have caused. Koontz sued, claiming that the proposed development conditions constituted a taking without just compensation and sought to recover monetary damages.

Requiring project applicants to pay to mitigate environmental impacts of their proposed projects has long been a standard part of the development process. The California Environmental Quality Act⁷ requires that the lead public agency examine the potential effects of the project and identify environmental impacts as well as mitigation measures and/or project alternatives which may serve to reduce or mitigate those impacts. Project applicants are typically required to modify their projects or agree to appropriate offsite improvements, or other exactions or dedications, to mitigate environmental consequences identified in an Environmental Impact Report. Impacts of the project on public infrastructure are also considered, and conditions of approval of development applications will likely take into account necessary modifications to streets and roads, schools, fire and police stations, parks and other public infrastructure which will be impacted by the proposed project. The guiding principle is that growth must pay for itself – that is, the impacts caused by new development on a community must be addressed by the proponent of that new development, through construction of needed public facilities, dedication of land for streets, parks, or other purposes, and payment of fees or monetary exactions designed to compensate for the impacts of the project.⁸

In 1987, the U.S. Supreme Court began to address the impact of overzealous local agencies imposing conditions on local projects which did not bear any relationship to the impacts of the project. In *Nollan v. California Coastal Commission*,⁹ the Supreme Court held that the government's

demand for a dedication of property from a property owner must have an “essential nexus” to the impacts of the project for which a permit was sought. The California Coastal Commission sought the dedication of an easement to permit lateral public access along the beachfront property of an owner who sought to remodel his home. The Supreme Court held that while such public beach access might be a desirable thing in the abstract, there was no nexus between Nollan’s remodeling application and the demand to dedicate the access easement. The condition therefore constituted a taking under the Fifth Amendment.¹⁰

The Supreme Court further refined this doctrine in 1994 in *Dolan v. City of Tigard*.¹¹ The Court held that not only must there be some theoretical nexus between the conditions imposed and the land use permit requested, but there must also be some rough proportionality between the amount of the exaction or dedication requested and the impacts of the project. In *Dolan*, the owner of a hardware store sought to remodel and expand the store. As a condition of granting the remodeling permit, the city sought among other things, dedication of property for a bicycle path. The Supreme Court found that while there was some theoretical relationship between enhancing access to the store and the additional patronage that might be expected from an expanded store, the condition in question was excessive in comparison to the impacts expected to be caused by the project. Any condition imposed by a local public agency must be roughly proportional to the impacts of the project or it, too, would be deemed a violation of the Fifth Amendment’s prohibition on takings without payment of just compensation.¹²

Koontz addressed and expanded the Court’s takings analysis. First, the government’s demand for property must satisfy the *Nollan/Dolan* requirements, even when the applicant refuses the condition and the permit is denied. Almost all substantial development applications are discretionary in nature. The permitting agency has the ability to deny the application if land use changes are requested, such as a general or specific plan amendment, zoning change, or issuance of a discretionary conditional use permit. Similarly, if a necessary Environmental Impact Report identifies significant environmental consequences of the project which cannot be mitigated, denial of the entire project is an option. In practice, public agencies will sometimes request, or developers will offer, dedications of land, construction of public improvements, or payment of fees which would be excessive under the *Nollan/Dolan* standards in order to convince the local public agency to grant the discretionary permit. From the developer’s perspective, this is sometimes sim-

ply a matter of political expediency— trying to get that third vote on the city council because the public benefits offered outweigh the particular council member’s misgivings about aspects of the project.

Sometimes, however, the local agencies’ discretionary power to approve or reject a project can result in an extortionate demand being placed upon a project applicant to agree in advance to accept a development condition which is either unrelated to the project or is grossly disproportionate to the impacts the project will cause.¹³ The *Koontz* decision addressed this situation. The majority in *Koontz* stated:

“Our decisions in [*Nollan/Dolan*] reflect two realities of the permitting process. The first is that land use permit applicants are especially vulnerable to the type of coercion that the unconstitutional conditions doctrine prohibits because the government often has broad discretion to deny a permit that is worth far more than the property it would like to take. By conditioning a building permit on the owner’s deeding over a public right-of-way, for example, the government can pressure an owner into voluntarily giving up property for which the Fifth Amendment would otherwise require just compensation ... Extortionate demands of this sort frustrate the Fifth Amendment right to just compensation, and the unconstitutional conditions doctrine prohibits them.”¹⁴

The majority and the dissent agreed that the *Nollan/Dolan* principles do not change depending on whether a permit application is approved based on the later satisfaction of an inappropriate condition, or is denied because the applicant will not agree to that same condition in advance. In either case, the issue of whether to grant the application was conditioned on an inappropriate and unconstitutional requirement.

The second issue decided by the *Koontz* Court was more controversial. The Court held that the government’s demand for money from a land use permit applicant must satisfy the *Nollan/Dolan* requirements. The Court held that a demand for money as a condition of permitting a specific parcel of property to be developed must satisfy the *Nollan/Dolan* standards. The dissent took issue with this concept. Justice Kagan, speaking for the four-member minority of the Court, stated:

“The boundaries of the majority’s new rule are uncertain. But it threatens to subject a vast array of land use regulations, applied daily in States and localities throughout the country, to heightened constitutional scrutiny.”¹⁵

The dissent was particularly concerned about the ability to distinguish between monetary exactions which must pass the heightened scrutiny of *Nollan/Dolan*, and taxes, which need not meet that heightened standard. The majority opinion acknowledges that the taxes are not takings, and states that its decision does not affect the ability of local governments to impose taxes. But, as the dissent points out, “the majority’s distinction between monetary ‘exactions’ and taxes is so hard to apply.”¹⁶ Although the majority says that distinguishing between an exaction and tax is not difficult on a case-by-case basis, it seems likely that there will be substantial litigation trying to sort out that very point.

ARE DEVELOPMENT IMPACT FEES NOW SUBJECT TO THE HEIGHTENED SCRUTINY OF *NOLLAN/DOLAN*?

California cities, counties and other permitting agencies have developed schedules of development impact fees imposed upon classes of properties and property owners seeking to develop their properties. Many of these fees have been adopted pursuant to the Mitigation Fee Act.¹⁷ The Mitigation Fee Act, also known as AB1600, requires that a local agency seeking to impose a fee as a condition of approval of a development project must determine, among other things, that there is a “reasonable relationship” between the fee’s use and the type of development on which the fee is imposed (the essential nexus)¹⁸ and how there is a “reasonable relationship” between the amount of the fee and the cost of the public facility attributable to the development on which the fee is imposed (the rough proportionality).¹⁹

In 1996, the California Supreme Court discussed the question of whether the reasonable relationship standard described in the Mitigation Fee Act differed from the heightened scrutiny of *Nollan/Dolan*. Although the plurality opinion in that case sought to interpret the “reasonable relationship” standard as identical to the *Nollan/Dolan* standard, the majority of the justices disagreed. As a result, *Ehrlich* stands for the proposition that the heightened standard of scrutiny found in *Nollan/Dolan* “is generally *not* applicable to development fees.”²⁰ Cases since *Ehrlich* have analyzed development fees based on a lesser standard, providing a level of deference to the legislative body adopting the fee. For example, in *San Remo Hotel v. City and County of San Francisco*,²¹ the Court stated:

“The ‘sine qua non’ for application of *Nollan/Dolan* scrutiny is thus the ‘discretionary deployment of the police power’ in

‘the imposition of land use conditions in individual cases.’ (*Ebrlich, supra*, 12 Cal. 4th at p. 869 (plur. opn.of Arabian, J.)) Only ‘individualized development fees warrant a type of review akin to the conditional conveyances at issue in *Nollan/Dolan*.’”

Monetary exactions, including *in lieu* fees which are the subject of an individualized calculation and imposed on a specific project, have been subject to *Nollan/Dolan* scrutiny since *Ebrlich*. In that sense, the decision in *Koontz* is not particularly significant for development in California. However, in response to *Ebrlich*, most communities have adopted development impact fees under the Mitigation Fee Act, and have imposed those fees on new development applications of various types. Some development impact fees are across-the-board fees imposed on virtually all applications for development within a community. Other agencies have adopted more specialized fees, only imposing them on certain types of development, or development within certain geographic areas.

Development impact fees are imposed upon a project as a condition of development. In that sense, and following the Court’s analysis in *Koontz*, these fees apply to a specific, identified property interest and require the owner to make a specified payment as a condition of proceeding with development. These fees may have been adopted as a result of an impact fee analysis which generally meets the deferential “reasonable relationship” standard of the Mitigation Fee Act. Even so, in particular cases it is likely that project applicants will believe the fee imposed lacks an essential nexus to the project which has been proposed, or more likely, that the fee is excessive, i.e. not roughly proportional to the specific project’s impacts on the community. It is therefore likely that development impact fees in certain communities will meet the standards of the Mitigation Fee Act, but will fail to meet the heightened scrutiny required by *Nollan/Dolan* when applied to the specific circumstances of a particular property or development project.

As pointed out by Justice Kagan in her dissent, the distinction between exactions and “taxes” in the broader sense, will be difficult to apply. Land use litigators representing developers will be quick to point out that development impact fees are not “taxes” because special taxes cannot be imposed without being approved by two-thirds of the electors. However, it is not clear whether the distinction drawn in *Ebrlich* between legislatively formulated development assessments imposed

on a broad class of property owners, which would be judged under the lesser rational relationship standard, and exactions imposed on a specific project on an individual and discretionary basis, which would be subject to heightened judicial scrutiny, is still a legitimate distinction.

Land use attorneys for applicants and public agencies will disagree with one another, but it is clear that the more a development impact fee looks like an individualized assessment on a particular piece of property, the more likely it will need to pass the heightened constitutional requirements of *Nollan/Dolan*. Similarly, if a fee imposed by local ordinance on a particular project is clearly excessive under the factual circumstances of the application, it stands a greater chance of being stricken by the court, no matter how reasonable the original analysis and report used by the municipality in establishing the fee seems to be. Permitting agencies considering the adoption of new impact fees would be well advised to analyze any new impact fees to be adopted on the assumption that the fees may be at some point analyzed using the heightened standards of *Nollan/Dolan* and *Koontz*.

WILL KOONTZ IMPACT NEGOTIATION AND USE OF DEVELOPMENT AGREEMENTS IN CALIFORNIA?

The *Koontz* case arose from discussions between the property owner and the permitting agency regarding conditions to be imposed. This is relatively common in any substantial development project. The majority of the justices in *Koontz* treated the alternatives described by the District as demands. Their analysis was based on the assumption that the requests for dedication of additional conservation easement area, or payment of a monetary exaction were, in essence, take it or leave it demands. The dissent took issue with this characterization and regarded the suggested options as merely part of a negotiating process. The record before the Supreme Court lacked this factual finding, allowing the justices to interpret the situation differently, depending upon their perspectives.

In practice, if a government agency, its staff, or one of its elected officials, makes what appears to be a demand that the developer agree to a specific concession as a condition of the agency granting a discretionary permit, there is a substantial likelihood that the demand will need to comply with the *Nollan/Dolan* requirements should the developer see fit to sue. On the other hand, if a public agency makes clear in discussing potential conditions that the discussion is exploratory only, that no demands are being made, and that only the council or governing board

can set conditions, there is a far better chance that the request will be treated as simply a part of an ordinary and healthy dialogue between a project applicant and permitting officials. In this regard, it is to be expected that agencies will seek to discuss potential conditions in the context of negotiations of a development agreement.²²

Cities and counties may enter into a development agreement with any person having legal or equitable interest in a parcel of real property for the development of that property.²³ Development agreements can provide some certainty in planning, particularly for projects that will continue in phases, or will not be completed for a significant period of time. They can provide an assurance to the applicant that city or county policies, rules, regulations and fees will remain as they are when the agreement is made, and the project will not be subjected to additional or more onerous future fees or requirements that may be adopted.²⁴ Development agreements can also deal with construction of public infrastructure and the reimbursement to a project applicant for construction of public infrastructure, particularly in housing projects.²⁵

A development agreement requires, by definition, negotiation and agreement between the parties. Discussions between the parties would typically be considered negotiations, and by definition development agreements are intended to commit each side to development terms that would not be available in the absence of the agreement. It is therefore hard to see how a suggestion made by a public agency as part of negotiating a development agreement could be construed as a demand that would invoke a *Koontz* analogy, absent some extraordinary circumstances. An exception to this approach might be a situation where a city or county has adopted a requirement that a development agreement must be used with respect to certain types of developments. Such a requirement would have other enforceability problems, but if a local ordinance makes use of a development agreement mandatory, a term of the agreement proposed by a city or county could well be construed as a demand. However, as long as the process is voluntary, it would seem that negotiations of potential development conditions in the context of negotiating a development agreement would eliminate the risk that a proposal by a city would be deemed a demand subject to heightened scrutiny. As a result, it is expected that cities and counties will preliminarily attempt to negotiate development agreements on a more frequent basis.

CONCLUSION

Koontz has been trumpeted by property rights advocates as a great victory for property owners.²⁶ It has been criticized by others as a blow to land use collaboration and as encouraging cities to either deny development altogether, or approve it without addressing its impacts.²⁷ Neither of these assessments is wholly accurate. In California, developers have the right to challenge individual conditions of approval.²⁸ Monetary exactions which are specifically imposed on an individualized basis have always been subject to *Nollan/Dolan* scrutiny. However, one area that seems unclear as a result of this ruling is the standard by which courts will analyze development impact fees. Is the reduced standard adopted in *Ehrlich* for assessing legislatively adopted impact fees still good law? Speaking for the majority in *Koontz*, Justice Alito stated that “teasing out the difference between taxes and takings is more difficult in theory than in practice.”²⁹ The guess from here is that it will take some time, and quite a bit of litigation, before that difference is analyzed adequately with respect to development impact fees.

NOTES

1. *Koontz v. St. Johns River Water Management Dist.*, 133 S. Ct. 2586 (2013) (*Koontz*).
2. *Kelo v. City of New London, Conn.*, 545 U.S. 469, 125 S. Ct. 2655, 10 A.L.R. Fed. 2d 733 (2005) (*Kelo*). In the controversial *Kelo* case, involving a woman who lost her home, the Court held that the city’s exercise of eminent domain power in furtherance of private economic development satisfied the constitutional “public use” requirement.
3. In *Nollan v. California Coastal Com’n*, 483 U.S. 825, 107 S. Ct. 3141 (1987), the Court held that there had to be an essential nexus between a demand for dedication of property as a condition of granting a development permit, and the impacts of the project for which the permit was sought.
4. In *Dolan v. City of Tigard*, 512 U.S. 374, 114 S. Ct. 2309 (1994), the Court held that even when there was a nexus between a permit condition and the impacts of the project, the extent of the condition had to be roughly proportional to the impacts of the project.
5. *Ehrlich v. City of Culver City*, 12 Cal. 4th 854, 50 Cal. Rptr. 2d 242, 911 P.2d 429 (1996) (*Ehrlich*).
6. *San Remo Hotel L.P. v. City and County of San Francisco*, 27 Cal. 4th 643, 117 Cal. Rptr. 2d 269, 41 P.3d 87 (2002) (*San Remo*).
7. Pub. Resources Code, §§21000 et seq.
8. 9 Miller & Starr, Cal Real Estate (3d ed. 2007, Supp. 2013), §§25:35 to 25:52.
9. *Nollan v. California Coastal Com’n*, 483 U.S. 825, 834-837, 107 S. Ct. 3141 (1987) (*Nollan*).
10. *Nollan, supra*, 483 U.S. at 834-837.
11. *Dolan v. City of Tigard*, 512 U.S. 374, 114 S. Ct. 2309 (1994) (*Dolan*).
12. *Dolan, supra*, 512 U.S. at 391.
13. For further discussion, see 11 Miller & Starr, Cal Real Estate (3d ed. 2006, Supp. 2013), §§30:16 to 30:35 (inverse condemnation; undue restrictions on property rights).
14. *Koontz, supra*, 133 S.Ct. at 2594-95.
15. *Id.* at 2604, dissent.

16. *Id.* at 2607, dissent.
17. Gov. Code, §§66000 et seq.
18. Gov. Code, §66001, subd. (a)(3).
19. Gov. Code, §66001, subd. (b).
20. *Ebrlich, supra*, 12 Cal. 4th at 887, Mosk concurring, italics in original.
21. *San Remo, supra*, 27 Cal. 4th at 670.
22. Gov. Code, §§65864 et seq.
23. Gov. Code, §65865, subd. (a).
24. Gov. Code, §65864, subd. (b).
25. Gov. Code, §65864, subd. (c).
26. See, for example, Pacific Law Foundation, PLF Liberty Blog posts including June 25 “PLF Statement on *Koontz v. St. Johns River Water Management District* Victory”.
27. See, for example, Sacramento Bee editorial, June 28, 2013 “Court Ruling a Blow to Land Use Collaboration.”
28. See, e.g., Gov. Code, §§66020 et seq.
29. *Koontz, supra*, 133 S.Ct. at 2601.

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