Enhancing the Value of California Real Estate

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Savvy developers, landowners, investors, lenders, and distressed property managers with foresight should seek to use every land use tool available to maintain the value of their entitlements or reposition their properties for value in the long term.

For decades, California has been the nation's premier thought-leader and legislative pioneer with respect to land use planning and environmental issues. While the state's goals have been lofty and its regulatory regime has attracted considerable positive attention, was its regulatory environment prepared for a global credit crisis? Can California's land use model adapt to the changed economic environment?

Historically, while real estate development has been cyclical, a reliable countervailing factor in California was that as the regulatory complexity grew, so did the value of obtaining entitlements. Entitled land was often worth up to hundreds of times its pre-entitlement value, and many developers could justify the cost of California's rigorous and lengthy entitlement process because of the potential financial upside once the property was entitled. In past down cycles, while the endeavor was riskier, the financial upside still sufficiently motivated owners and developers to pursue entitlements. Today, California developers are asking themselves whether it is still worth it to entitle and develop property.

These peculiar times have also seen a rapid change in the mix of players. Joining the ranks of traditional developers is a host of lenders, investors, and distressed asset funds, some relatively new to California's complex rules. While time will ultimately tell whether the state's regulatory environment can adapt to and survive the changed economic environment, savvy owners and developers are finding ways to maximize value and prosper in the interim. Land use in California is different today than it was two years ago, but it is alive and well.

Preserving Entitlements, Renegotiating Fees, and Repositioning Projects

In general, entitled land in California remains more valuable than unentitled land. Due to the time, expense, and uncertainty in obtaining entitlements, developers, landowners, and, increasingly, investors and foreclosing lenders should be highly motivated to preserve entitlements and seek to renegotiate them wherever possible.

Extending the life of entitlements has become of paramount importance as credit and capital availability lag. As in past economic downturns, the California legislature has enacted laws extending the life of subdivision maps. Enacted in 2008, Senate Bill 1185 provides an automatic one-year extension for certain subdivision maps. It also authorizes local governments, at their discretion, to approve an additional one-year extension of a tentative map. Administrative or other approvals issued by certain state agencies are also automatically extended by one year under this legislation. In July, another two-year legislative extension was enacted, providing additional protection for existing tentative and parcel maps.

In California, there is another mechanism to extend subdivision maps much longer. Statutory development agreements enable subdivision maps to be extended for the term of the development agreement, which can be 20 years or more. Impact fees and related exactions may also be negotiated and "locked in" through development agreements, together with zoning and other entitlements. Such agreements, upheld by *Santa Margarita Area Residents Together v. San Luis Obispo County*, transcend political transitions as city councils and county boards of supervisors change over time.

Similarly, in redevelopment areas, master developers may have negotiated not only a development agreement, but also a disposition and development agreement (DDA), which embodies the business terms and long-term phasing of the project. During the current economic downturn, in certain instances developers and redevelopment staff, as public/private partners, are working together to reexamine proposed development, identify flexibility, and adapt projects for mutual benefit. Substantive amendments to the existing DDA and project approvals, including the development agreement, can preserve and enhance value and extend the life of the project to correspond with future economic recovery.

In recent years, monetary (e.g., impact fees) and nonmonetary (e.g., dedications) exactions have grown exponentially in California. Traditional fees imposed to mitigate impacts to public infrastructure expanded to include affordable housing, child care, and loss of agricultural land. In addition, many fees reflect high "level of service" standards and peak-of-the-market land acquisition, and construction costs. The fees that developers used to live

with fail to reflect current market realities and may render projects infeasible. In response to statewide reform efforts spearheaded by trade organizations, many cities have reduced and deferred their fees. For projects where high impact fees have not yet been paid, owners and developers could seek significant reductions as part of their general evaluation of project conditions and repositioning efforts.

Environmental Impact Review and Green Building Issues

Just as extending the life of or modifying existing entitlements has become critical, reducing the length of time required for developer-funded environmental review of unentitled or modified projects can substantially reduce costs and add value to a project. California's mandatory environmental review statute—the California Environmental Quality Act, commonly referred to as CEQA—provides multiple tools and processes for streamlining environmental review. (See "Little NEPA Statutes," page 144.)

In addition, numerous CEQA exemptions are available to specific classes of development projects. For example, as a result of the enactment of Senate Bill 375 in 2008, which seeks to statutorily link land use and transportation planning in an effort to reduce greenhouse gas emissions, certain "transit priority projects" are exempt from CEQA. "Transit priority projects" are projects with at least 50 percent residential use and a minimum net density of 20 dwelling units per acre (49 dwelling units per ha), located within a half mile (0.8 km) of a major transit stop or high-quality transit corridor included in a regional transportation plan. By using these types of exemptions and other streamlining techniques, an otherwise lengthy entitlement process can potentially be simplified, with developers achieving significant cost savings and adding value to otherwise unentitled property.

Despite the downturn, local jurisdictions throughout California also continue to impose mandatory green building requirements. In some cases, these requirements are tied to the Leadership in Energy and Environmental Design (LEED) rating system developed by the U.S. Green Building Council. For several years preceding the economic downturn, the standard developer response was that these new requirements imposed substantial costs that only added to the complexity and expense of development projects. Today, the tide appears to be turning, with California developers recognizing the potential marketing and business benefits to be obtained by a green-certified project. In addition, cities such as San Francisco offer expedited processing for green projects.

CUNINGHAM GROUP

Construction of the seven-story Madrone condominiums in Hollywood, California, designed by the Cuningham Group, was halted earlier this year after the developer, John Laing Homes, declared bankruptcy.

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Creating Working Capital through Fee Refunds and Reimbursements

When real estate values were escalating, developers often prepaid impact fees to avoid proposed increases. In many instances, lots for which fees were paid have not yet been built out and remain dormant. In addition, developers were often required to build oversized infrastructure to serve neighboring projects, with the expectation of future reimbursements from other developers and agencies. As projects falter and developers lay off the employees who managed them, considerable fee payments and reimbursement rights may be forgotten, leaving substantial sums in others' hands.

In projects now dormant after fees were paid, owners should consider seeking refunds rather than allowing agencies to bank fees as credits. Refunds may be justified because the anticipated impacts are not occurring, and fees can be "recollected" when building permits are subsequently pulled. Refunds are attractive to create working capital. If a project is sold, the market may not give dollar-for-dollar value for prepaid fees left as credits, since it could be years before homes are built and their value is realized.

In the case of reimbursements, sometimes obtaining them is merely a matter of auditing the project records and making requests to the appropriate parties. Similarly, owners may be able to invoke various reimbursement stat-

utes that prevent "double payment," e.g., if facilities covered by fees were also funded by assessment districts or the state.

The global credit crisis has caused a domino effect. California is experiencing an unprecedented budget crisis, the likes of which have not been seen since World War II. In its search for funding sources, the state is seeking to take or borrow local government revenues, and in particular redevelopment funds. In addition, as cities and counties become increasingly affected, developers will face planning and redevelopment staff reductions, which will likely increase the time and, as a result, the cost of obtaining approvals.

The California economy, though hit hard in the current global crisis, is expected to climb out of the downturn faster than other parts of the United States. Savvy developers, landowners, investors, lenders, and distressed property managers with foresight should seek to use every land use tool available to maintain the value of their entitlements or reposition their properties for value in the long term. Land use in California is not dead; quite the contrary, it is alive and well, and offers a multiplicity of tools for enhancing the value of real estate there. UL

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Little NEPA Statutes

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TO DATE, DOMESTIC LEGAL EFFORTS to forestall climate change have been led by states, not the federal government. In the landmark case *Massachusetts v. EPA*, 549 U.S. 497 (2007), the U.S. Supreme Court held that federal regulation of climate-changing greenhouse gases (GHGs) was permissible under existing law, interpreting the Clean Air Act to give the Environmental Protection Agency (EPA) the authority to regulate carbon dioxide (CO_2). But on July 11, 2008, the EPA, with support from the White House, refused to do so, stating that the Clean Air Act is "the wrong tool" for addressing climate change.

President Obama pledged to reverse this course, and encouraged Congress to pass nationwide climate change legislation. On June 26, 2009, the House, in a 219-to-212 vote, passed the 1,300-plus-page Waxman-Markey bill, which, if made law, would "cap" GHGs to 17 percent below 2005 levels by 2020 and to 83 percent below those levels by 2050. It would require major GHG sources to amass buyable, sellable carbon credits equal to their GHG emissions. The Senate takes up the bill this fall in an increasingly contentious political landscape leading up to the United Nations' Summit on Climate Change in Copenhagen in December.

But independent of any potential outcomes from future federal legislation or international negotiations, a principal way by which state and local governments are attempting to meet state goals for reducing GHGs is by using "mini NEPA" or "little NEPA" statutes—laws requiring public agencies and some private businesses to consider the environmental impacts of their proposed development activities. The pioneers of this movement, Massachusetts and California, require state agencies and some private developers to quantify the direct and indirect GHG emissions caused by activities such as new construction of state facilities.

Little NEPA statutes largely mirror their federal predecessor, the National Environmental Policy Act (NEPA), 42 U.S.C. § 4321 et. seq. Under NEPA, before a federal agency may implement a "major federal action," the agency must prepare a detailed statement that assesses the environmental impacts of, and alternatives to, the action. This statement is commonly known as an environmental impact