St. Mary's Law Journal

Volume 19 | Number 2 Article 3

1-1-1987

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NEW WAVE LAND USE REGULATION: THE IMPACT OF IMPACT FEES ON TEXAS LENDERS*

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* This article is a modified version of the program materials for the topic "Zoning and Land Use: Development Exactions," prepared by the authors for the 21st Annual Mortgage Lending Institute held in Austin, Texas (October 1-2, 1987).

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I. INTRODUCTION

> The rapid refinement of [off-site exaction] systems has been akin to a tidal wave. However, in the rush by local government to tap these attractive sources of new . . . revenues, there is growing concern that the "zoning game" is being replaced with a new "impact fee game."[1]

Few, if any, controversies in current land use and development law rival the debate concerning the use and validity of developer exactions and impact fees.[2] As a condition to approving a subdivision, cities have traditionally required (i) dedication of land for streets, utilities, and even for parks or schools, and construction of street, utility, or similar improvements within the subdivision, or (ii) payment of "in-lieu" fees directly related to such subdivision improvements.[3] These requirements are viewed almost universally as reasonable exercises of

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1. Duncan, Morgan & Standerfer, *Simplifying and Understanding the Art and Practice of Impact Fees* at 7, in DEVELOPMENT EXACTIONS CONFERENCE (1986)(course materials for conference sponsored by the Homer Hoyt Center for Land Economics and Real Estate, Florida State University).

2. *See* Babcock, *Foreword* to *Exactions: A Controversial New Source for Municipal Funds*, 50 LAW & CONTEMP. PROBS. 1, 1 (1987). "Every half decade or so, zoning comes forth with a hero, a *bette noire*, or an Armageddon of some sort. . . . Today, it is exactions." *Id.*

3. Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING AND EMINENT DOMAIN § 2.02, at 2-4 to 2-7.

police power by a municipality.[4] The financial needs of most growing cities, however, have outgrown traditional financing schemes, and creative "cost-shifting" alternatives are now appearing that test the legal limitations upon municipal land use regulation.[5] "Impact fees" — charges to generate capital funding necessitated by growth (for example, to pay for roadway improvements outside a subdivision or for a new water treatment plant) — and "linkage" — charges to fund programs related to social policies (such as the provision of low-cost housing, child care, or public transit) — are becoming popular planning devices,[6] and materials are available to guide local officials in implementing programs that will withstand challenges to their legality.[7] Of course, materials are also available to outraged developers (and their counsel) to assist them both in evaluating the validity of an aggressive exaction program and in understanding why such programs are likely here to stay.[8]

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4. *See, e.g.*, White v. County of San Diego, 608 P.2d 728, 732 n.2 (Cal. 1980)(power to require land dedication as condition to development well established)(citing Ayres v. City Council of Los Angeles, 207 P.2d 1, 7-8 (Cal. 1949)); Brous v. Smith, 106 N.E.2d 503, 506-07 (N.Y. 1952)(conditioning construction permit on dedication of access roads is valid exercise of police power); *see also* Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2.02, at 2-5. *But see* Berger, *Real Estate Developers' Linkage Fees: Reasonable Requirement or EXTORTION?*, PROB. & PROP., Jan.-Feb. 1987, at 9. Berger notes:

> [Governmental planners] used to talk of having land developers "dedicate" property (or pay fees in lieu of dedication) as a condition of project approval, when what they were really engaged in has been called by one state supreme court "extortion" and by another "grand theft."

Id. (quoting Collis v. City of Bloomington, 246 N.W.2d 19, 26 (Minn. 1976)(exactions disproportionate to subdivision's needs transforms acceptable use of police power into grand theft) and J.E.D. Assocs. v. Town of Atkinson, 432 A.2d 12, 14-15 (N.H. 1981)(regulation extorting property without just compensation is unreasonable)).

5. *See* Bauman & Ethier, *Development Exactions and Impact Fees: A Survey of American Practices*, 50 LAW & CONTEMP. PROBS. 51, 51-52, 54-55 (1987)(introducing causes of crisis in municipal finances and constitutional challenges to cost-shifting alternatives).

6. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 71-72 (1987).

7. *See, e.g.*, Duncan, Morgan & Standerfer, *Simplifying and Understanding the Art and Practice of Impact Fees*, in DEVELOPMENT EXACTIONS CONFERENCE (1986)(course materials for conference sponsored by the Homer Hoyt Center for Land Economics and Real Estate, Florida State University).

8. *See, e.g.*, Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2; Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69 (1987); Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5 (1987).

This article will focus on the concerns of Texas mortgage lenders facing this new wave of municipal exactions. Section II will begin with a brief overview of the authority for and types of developer exactions, and will conclude with a summary of legal limitations on local government exaction practices. Section III will survey the Texas cases relevant to exactions and will include a summary of the new statute authorizing Texas cities to collect impact fees. In Section IV, we will offer some practical suggestions for mortgage lenders and their attorneys, with special attention to the effect of impact fees on the borrower's finances, the collateral, and loan documentation.

II. DEVELOPER EXACTIONS: EVOLUTION IN PROGRESS

A. *Municipal Regulatory Authority*

While the right to hold and use private property is fundamental in our legal system,[9] courts have consistently recognized the "police power" of government to protect "the safety, health, morals and general welfare of the public."[10] "There can be no dispute that the police power of the States encompasses the authority to impose conditions on private development."[11] Police powers are, however, "to be exercised only for the public good,"[12] and the term "police power" nowadays "connotes the time-tested conceptional limit of public encroachment upon private interests."[13] Governmental interference

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9. *See* Lynch v. Household Fin., 405 U.S. 538, 552 (1972)(property rights long recognized as basic civil rights). "It is very clear that the founders [of the United States] shared Locke's and Blackstone's affection for private property . . . ." R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 29 (1985). Epstein continues, "Locke was emphatic in his emphasis that individual natural rights, including rights to obtain and hold property, are not derived from the sovereign but are the common gift of mankind." *Id.* at 10 (citing J. LOCKE, OF CIVIL GOVERNMENT ch. 5 (1690)). Blackstone asserted that the right of property is absolute, "inherent in every Englishman," and "probably founded in nature." 1 W. BLACKSTONE, COMMENTARIES *138.

10. Lochner v. New York, 198 U.S. 45, 53 (1905); *see also* Berman v. Parker, 348 U.S. 26, 32 (1954)(traditional application of police power includes public health and safety, peace and quiet, morality, law and order); Noble State Bank v. Haskell, 219 U.S. 104, 111 (1911)("the police power extends to all [of] the great public needs").

11. Nollan v. California Coastal Comm'n, __ U.S. __, __, 107 S. Ct. 3141, 3151, 97 L. Ed. 2d 677, 693 (1987)(Brennan, J., dissenting).

12. R. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 15 (1985); *see also* Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229, 240 (1984)(public use requirement coterminous with scope of state's police powers); Berman v. Parker, 348 U.S. 26, 35 (1954)(public purpose is condition precedent to police power legislation).

13. Nollan, __ U.S. at __ n.1, 107 S. Ct. at 3151 n.1, 97 L. Ed. 2d at 693 n.1 (Brennan, J., dissenting).

with private property, in one classic formulation, must be required by the "interests of the public," and the "means [must be] reasonably necessary for the accomplishment of the purpose, and not unduly oppressive upon individuals."[14] Generally, local governments have no inherent police power, and their authority to regulate land development must come from the state.[15] Many states, however, grant broad "home rule" powers to their large cities.[16] For example, Texas cities with populations over 5,000 can adopt home rule charters and thereby become empowered to do virtually anything within their corporate limits that the state constitution and general state law do not prohibit.[17] Additionally, Texas cities have been authorized by the legisla-

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14. Lawton v. Steele, 152 U.S. 133, 137 (1894).

15. *See, e.g.*, City of Trenton v. New Jersey, 262 U.S. 182, 187 (1923)(absent state constitutional provision, municipal right of self-government controlled by state legislature); Brown v. City of Galveston, 97 Tex. 1, 14, 75 S.W. 488, 495 (1903)(municipal corporation's existence and powers determined entirely by state legislature); Vosburg v. McCrary, 77 Tex. 568, 572, 14 S.W. 195, 196 (1890)(city powers limited by statutes); State *ex rel.* Burnet County v. Burnet County Hosp. Auth., 495 S.W.2d 300, 304 (Tex. Civ. App.—Austin 1973, writ ref'd n.r.e.)(inherent right of municipal self-government non-existent). One commentator explains:

> It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: First, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation, — not simply convenient, but indispensable. Any fair, reasonable, substantial doubt concerning the existence of power is resolved by the courts against the corporation, and the power is denied. Of every municipal corporation the charter or statute by which it is created is its organic act. Neither the corporation nor its officers can do any act, or make any contract, or incur any liability, not authorized thereby, or by some legislative act applicable thereto. All acts beyond the scope of the powers granted are void. Much less can any power be exercised, or any act done, which is forbidden by charter or statute. These principles are of transcendent importance, and lie at the foundation of the law of municipal corporations.

1 J. DILLON, COMMENTARIES ON THE LAW OF MUNICIPAL CORPORATIONS § 237 (5th ed. 1911).

16. *See, e.g.*, FLA. CONST. art. VIII, § 2(b); ME. CONST. art. VIII, pt. 2, § 1; PA. CONST. art. IX, § 2; TEX. CONST. art. XI, § 5. The adoption of a "home rule" law enables a city to exercise full power of self-government. Tuck v. Texas Power & Light Co., 543 S.W.2d 214, 215 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.). Home rule cities derive power from the constitution rather than from the legislature and are authorized to exercise any power that, absent the constitutional provision, the legislature could have authorized. Lower Colo. River Auth. v. City of San Marcos, 523 S.W.2d 641, 643 (Tex. 1975).

17. *See* TEX. CONST. art. XI, § 5. The purpose of the article was "to bestow upon the cities coming under the Home Rule Amendment 'full power of local self-government' " and to permit each city to draft or amend its own individual charter. City of Houston v. State *ex rel.* City of West Univ. Place, 142 Tex. 190, 192, 176 S.W.2d 928, 929 (1943)(quoting City of Houston v. City of Magnolia Park, 115 Tex. 101, 110-11, 276 S.W. 685, 689 (Tex. Comm'n App. 1925, opinion adopted)).

ture to extend their subdivision ordinances into their extraterritorial jurisdiction.[18] With such broad authority, the municipal power of home rule cities to regulate land use is primarily limited by the police power requirement that a regulation, such as an exaction program, be reasonably related to a public purpose.[19]

B. *Types of Exactions*

As a condition to subdivision approval, zoning changes, or the issuance of conditional use or other permits, municipalities typically require developers to make contributions, termed "exactions," of land, improvements, or money.[20] Developer exactions, like zoning and other municipal land use restrictions, are imposed pursuant to the police power.

1. Dedication and In-Lieu Fees

Dedication of a portion of the land in a project for streets, sidewalks, and utility lines is the least controversial and most often used form of exaction.[21] Requiring actual construction of streets, side-

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18. TEX. REV. CIV. STAT. ANN. art. 970a, § 4 (Vernon 1963). "Extraterritorial jurisdiction" is defined as "the unincorporated area, not a part of any other city, which is contiguous to the corporate limits of any city, to the extent described [in the statute] . . . . " *Id.* § 3(A). The statute sets the extraterritorial jurisdiction for cities at different distances beyond the corporate limits, based on population. *See id.* § 3(A)(1)-(5). The statute permits a city to enjoin violations of an ordinance applicable in its extraterritorial jurisdiction, but prohibits exaction of fines for such violations. *Id.* § 4.

19. A home rule city may exercise any power not inconsistent with the city charter, the state constitution, or state statutes. *See, e.g.*, Cook v. City of Addison, 656 S.W.2d 650, 654-56 (Tex. App.—Dallas 1983, writ ref'd n.r.e.)(city's action upheld because home rule powers not inconsistent with constitution or state statutes); City of Brownsville v. Pub. Util. Comm'n, 616 S.W.2d 402, 407 (Tex. Civ. App.—Texarkana 1981, writ ref'd n.r.e.)(legislature may limit cities' home rule powers); Jones v. International Ass'n of Firefighters, 601 S.W.2d 454, 460 (Tex. Civ. App.—Corpus Christi 1980, writ ref'd n.r.e.)(city's home rule power upheld because state statute doesn't limit power with unmistakable clarity). Of course, the fourteenth amendment's procedural due process and equal protection requirements and the fifth amendment's proscription of taking without just compensation also limit municipal regulatory authority. *See, e.g.*, City of Cleburne v. Cleburne Living Center, 473 U.S. 432, 447-50 (1985)(applying equal protection clause to zoning ordinance).

20. *See generally* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 70 (1987).

21. *See, e.g.*, 4 R. ANDERSON, AMERICAN LAW OF ZONING 3D § 25.25, at 352 (1986); Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 70 (1987). "A 'dedication' is a donation or appropriation of property to the public use by the owner." City of Fairfield v. Jemison, 218 So. 2d 273, 275 (Ala. 1969).

walks, and utility lines within a subdivision is also common.[22] Such intradevelopmental exaction schemes are viewed as fair because the costs of growth are borne by those who created the need and will benefit from the exaction.[23] Such schemes are also legally justifiable because of the municipality's legitimate health, safety and welfare interests.[24] Dedications of land within a proposed subdivision for recreational and educational purposes are similarly required by many cities.[25]

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22. *See* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 70 (1987); Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2.02[1][a]; Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415, 418 (1981).

23. Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2.02[1][a] (exaction schemes fairly distribute costs of infrastructure).

> The proposition that new residents should bear the capital expenses they create would not seem unfair. In the absence of capital cost shifting devices the developer reaps windfall profits. After all, the developer "sells" his customer the schools, recreational facilities, fire protection, etc., that are primarily paid for by the older residents of the community.

Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415, 416 n.5 (1981).

24. *See, e.g.*, Stewart v. Stone, 130 So. 2d 577, 579 (Fla. 1961)(map and plat law adopted by city officials within public purposes of police power); *In re* Application of Marques, 37 Haw. 260, 265 (1945)(ordinance regulating subdivision plan is municipal police measure); Mansfield & Swett v. Town of W. Orange, 198 A. 225, 229 (N.J. 1938)(regulations governing subdivision of city serve to protect and promote public's safety, health and morals).

25. *See, e.g.*, Aunt Hack Ridge Estates v. Planning Comm'n, 230 A.2d 45, 47 (Conn. Super. Ct. 1967)(municipal planning commission has constitutional power to allocate subdivision lots for parks and playgrounds); Krughoff v. City of Naperville, 354 N.E.2d 489, 494 (Ill. App. Ct. 1976)(city plan providing for park and school sites within city's government powers); Billings Properties v. Yellowstone County, 394 P.2d 183, 187 (Mont. 1964)(plans for public recreational facilities and schools necessary for city's development)(citing Pioneer Trust & Sav. Bank v. Village of Mount Prospect, 176 N.E.2d 799, 801 (Ill. 1961)); *In re* Lake Secor Dev. Co., 252 N.Y.S. 809, 811-12 (Sup. Ct. 1931)(city planning board has power to determine what areas used for park and recreational purposes); Jordan v. Village of Menomonee Falls, 137 N.W.2d 442, 448-49 (Wis. 1965)(required land dedication for educational, park and recreational purposes pursuant to city ordinance is constitutional exercise of city's police power), *appeal dismissed*, 385 U.S. 4 (1966). *But see, e.g.*, Gordon v. Village of Wayne, 121 N.W.2d 823, 825 (Mich. 1963)(village unauthorized under plat statute to require subdividers to donate land or monetary equivalent for park purposes as condition for approval of development plats); Ridgemont Dev. Co. v. City of E. Detroit, 100 N.W.2d 301, 305 (Mich. 1960)(under state statute, city not empowered to require subdividers to donate lots for public playgrounds as condition for approval of subdividers' plats); Kamhi v. Planning Bd., 452 N.E.2d 1193, 1196 (N.Y. 1983)(statute providing for land dedication does not authorize city to compel uncompensated transfer from developer for streets or recreational purposes). *See generally* 4 R. ANDERSON, AMERICAN LAW OF ZONING 3D §§ 25.39-25.40 (1986)(discussing mandatory

Recognizing that a project creates burdens on streets and utility systems beyond its boundaries, cities often require dedication of land on the boundaries of the project and construction of certain off-site improvements. Examples include requiring construction or rehabilitation of a street near the project and requiring off-site extension of water or sewer lines that serve the project.[26] Such exactions are generally upheld if the need for the improvements, and the benefits from them, can be traced to the project and not to surrounding projects or the general population.[27]

Where dedications are impractical, as in a series of small developments, some cities impose "in-lieu" fees that represent the project's share of the cost of improvements necessitated, at least in part, by the project. Fees of this sort effectively shift to the new development the cost of improvements that would otherwise burden the general municipal revenues.[28] In-lieu fees, when authorized statutorily, directly re-

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dedications of land for recreational areas); *id.* § 25.41 (discussing reservation or dedication of property for educational purposes).

26. Connors & Meacham, *Paying the Piper: What Can Local Government Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2.02[1][b]. These commentators note:

> Local governments faced with a proliferation of subdivisions realized that, in terms of the services customarily provided by local government, a housing subdivision created needs beyond the boundaries of the subdivision. It placed additional strain, for example, on nearby roadways and connecting sewer and water lines. Having successfully required developers to provide their own intradevelopment improvements, municipalities began also to require the construction of off-site improvements as a condition of subdivision approval. These off-site exactions typically include two types of work: first, the construction or rehabilitation of streets and highways bounding, crossing, or even existing near the subdivision; and, second, the extension of city water and sewer mains and storm drains that pass through the subdivision and extend out from it to service other areas.

Id.; *see also* Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5, 7-8 (1987).

27. *Compare* Ayres v. City Council of Los Angeles, 207 P.2d 1, 6-7 (Cal. 1949)(reasonable to require subdivider to dedicate right-of-way along street bordering subdivision) *and* Hudson Oil Co. v. City of Wichita, 396 P.2d 271, 275 (Kan. 1964)(dedication of land for frontage streets "to maintain uniformity in streets, service and access streets" reasonable prerequisite to plat approval) *with* Arrowhead Dev. Co. v. Livingston County Rd. Comm'n, 322 N.W.2d 702, 709 (Mich. 1982)(county lacked authority to require off-site improvements) *and* Divan Builders v. Planning Bd., 334 A.2d 30, 41 (N.J. 1975)(no authority to require contribution to cost of off-site drainage facility where other projects generally benefitted and cost not allocated to such other projects).

28. *See* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 71 (1987)(municipality may collect and pool fees from series of small developments, shifting direct costs of growth to new residents).

lated to a need arising because of the new development, and used for purposes benefitting residents of the new development, are now as uncontroversial as subdivision dedications.[29]

2. Impact Fees

Municipalities also face growing financial burdens that are not directly related to specific new developments that have been submitted for municipal approval. For example, the need may exist for a new water treatment plant or road system to serve an entire town.[30] However, cutbacks in federal grant and subsidy programs, limitations on local government access to tax-free industrial bonds, population growth, and decreases in state and federal taxes have triggered financial crises in many cities.[31] Confronted with new inabilities to pay for the utility improvements, roads, parks, and educational facilities required by growth, cities anxiously search for alternative sources of funds.

The development community is a ready target of this quest. The imposition of impact fees to allocate to new developments the costs of

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29. *See id.* In-lieu fees have not always been uncontroversial. *Compare* Associated Home Builders v. City of Walnut Creek, 484 P.2d 606, 611-12 (Cal.)(en banc)(upholding statute requiring subdivider to dedicate land or pay fees for park and recreational purposes on basis of general public needs for such facilities and specific benefit to subdivision residents), *appeal dismissed*, 404 U.S. 878 (1971) *and* Call v. City of W. Jordan, 606 P.2d 217, 220 (Utah 1979)(ordinance requiring developer to dedicate proposed subdivision land or to pay cash equivalent for use as flood control and/or recreational facilities is reasonable in view of benefit both to subdivision and whole community) *and* Jordan v. Village of Menomonee Falls, 137 N.W.2d 442, 448-49 (Wis. 1965)(ordinance mandating cash payment in lieu of land dedication for educational or recreational needs is reasonable exercise of police power, since subdivision will increase community needs for these facilities), *appeal dismissed*, 385 U.S. 4 (1966) *with* Rosen v. Village of Downers Grove, 167 N.E.2d 230, 234 (Ill. 1960)(statute permitting municipalities to require land dedication for public grounds does not authorize municipalities to require cash payments) *and* Coronado Dev. Co. v. City of McPherson, 368 P.2d 51, 53 (Kan. 1962)(fact that cash payment was to be used to purchase land for public areas did not put regulation within city's authority under enabling statute) *and* Haugen v. Gleason, 359 P.2d 108, 111 (Or. 1961)(en banc)(county ordinance exacting fee as condition of subdivision approval is valid exercise of police power only if funds used exclusively for benefit of subdivision).

30. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 71 (1987); *see also* Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415, 415 (1981)(modern suburbia's rapid, sprawling growth exerts intense pressure for new facilities).

31. *See* Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 2 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

such public improvements is growing more popular as a municipal financing mechanism.[32] Although more controversial and susceptible to legal challenges, if such fees are "equitably implemented, that is, if proportionate payments and empirical data tie cost increases to new development, [impact fees] have the indicia of a legitimate method of land use regulation."[33]

3. Special Assessments

Another popular form of exaction in many cities is the special assessment—a charge for improvements levied against a property that is specifically benefitted by the improvements.[34] Generally, special assessments are valid only if (i) the subject improvements increase the value of the property assessed, and (ii) the benefit to the assessed property is substantially greater than the benefit to the general public.[35]

Municipal authority to exact special assessments may originate in a state constitution, a state statute, or home rule powers, and without such authority a special assessment scheme is typically rejected as an illegal tax.[36] In Texas, for example, cities are authorized by statute to assess costs of curbs, gutters and sidewalks against property abutting a highway to be improved,[37] in view of "the special benefits in en-

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32. Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415, 417 (1981)(impact fees playing greater role in local government effort to generate revenue for facilities necessitated by population growth).

33. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 72 (1987). For a general discussion of the extensive use of, and litigation concerning, impact fees in Florida, see Connors & Meacham, *Paying the Piper: What Can Local Governments Require as a Condition of Development Approval?*, 1986 INST. ON PLAN. ZONING & EMINENT DOMAIN § 2.02[d]. For an analysis of the evolution of, legal challenges to, and Florida experience with impact fees, see generally Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415 (1981).

34. *See generally* Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 7-8 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

35. *Id.*

36. *Id.* ("The grant of power to impose special assessment[s] is perceived as a modified grant of the taxing power.").

37. TEX. REV. CIV. STAT. ANN. art. 1105b (Vernon 1963 & Supp. 1987). The statute provides:

> [T]he governing body of any city shall have power to determine the necessity for, and to order, the improvement of any highway, highways, or parts thereof within such city, and

hanced value to be received by" the abutting property owner.[38]

4. Linkage

The exactions discussed above are usually related to efforts by municipalities to offset the burdens of growth upon existing street and utility systems. While a fine distinction can be made between in-lieu fees to pay for water lines outside of but serving a subdivision, and an impact fee that allocates the cost of a new water treatment plant serving many subdivisions, the relationship between the burdens of growth, the fee charged, and the benefits to the new development is usually clear.[39] However, in some areas of the country, the search for innovative methods of financing community services has led to the imposition of linkage fees, which "link" approval of a development to the provision of low cost housing, public transit, child care, jogging trails, public art, job training, or even bookmobiles.[40] Linkage fees are by far the most controversial form of exaction. Some commentators argue:

> [W]hile one can rationally understand the relationship between roads and sewers and a new subdivision or office building, . . . [the] "need" [for public art, child care, job training, or the like is] created by society, not by a particular development. Cities exacting such things are plainly skating close to (and, I believe, over) the line.[41]

The "line" of legality, involving questions of a municipality's power to exact linkage fees and, where the power exists, the constitutional limits upon exercising such power, is not clear.

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to contract for the construction of such improvements in the name of the city, and to provide for the payment of the cost of such improvements by the city, or partly by the city and partly by assessments as hereinafter provided.

Id. § 3 (Vernon 1963).

38. *Id.* § 7 (Vernon Supp. 1987); *see also id.* art. 1110c (Vernon 1963 & Vernon Supp. 1987)(allowing cities to levy assessments against benefitted land for water and sewer system improvements).

39. *See* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 72 (1987).

40. Berger, *Real Estate Developers' Linkage Fees: Reasonable Requirement or EXTORTION?*, PROB. & PROP., Jan.-Feb. 1987, at 9. For a discussion of linkage programs in Chicago, Kansas City, Seattle, and Stamford, see generally Taub, *Exactions, Linkage and Regulation Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 18-22, 29-30 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

41. Berger, *Real Estate Developers' Linkage Fees: Reasonable Requirement or EXTORTION?*, PROB. & PROP., Jan.-Feb. 1987, at 9.

C. *Legal Challenges*

In this section, challenges to and standards for evaluating developmental exactions will be considered. One should recognize at the outset, however, that the difficult theoretical analysis of the validity of an exaction program is often disregarded in the interest of time and money.

> If there is one thing most developers hold dear, it is time. Delay — in terms of holding costs, construction costs, interest, etc. — is often more expensive than illegal linkage fees. Thus, many developers will grumble, but they will pay.[42]

Even if one does not adopt the view that anxious developers inevitably fall prey to "orchestrated bribery"[43] because city approvals are the key to a developer's success or failure, the fact that cases involving the legality of exactions are sometimes confusing, circular, or outcome determinative will give little motivation for a developer, or its lender, to stop a project and challenge the governing authorities. The relative impotence of judicial review in time-sensitive development projects, therefore, exaggerates the potential for abuse by municipalities.

The legal challenges to developer exactions fall roughly into three categories: (i) claims that the municipality lacks the requisite authority to impose a particular exaction; (ii) claims that the exaction is unconstitutional because it is an impermissible form of taxation; and (iii) claims that an exaction is unconstitutional because it is unrelated to an improvement necessitated by the new development.[44]

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42. *Id.* at 9-10.

43. *Id.* at 10. Because a developer's willingness or ability to provide funds for the "pet project" (public art, child care, etc.) of a city councilman or city planner is unrelated to the merits of the proposed development, the existence of linkage fees "comes dangerously close to smelling a lot like orchestrated bribery" rather than reflecting good municipal planning. *Id.* The United States Supreme Court recently espoused a similar view: "In short, unless the permit condition [access easement] serves the same governmental purpose as the development ban, the building restriction is not a valid regulation of land use but an 'out-and-out plan of extortion.' " Nollan v. California Coastal Comm'n, __ U.S. __, __, 107 S. Ct. 3141, 3148, 97 L. Ed. 2d 677, 689 (1987)(quoting J.E.D. Assocs. v. Town of Atkinson, 432 A.2d 12, 14 (N.H. 1981)).

44. *See generally* Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5, 9-16 (1987)(analysis of ultra vires objection, reasonableness tests, and impermissible tax objection).

1. Challenges to Authority

Courts sometimes invalidate a municipal ordinance after finding that the ordinance is not expressly authorized by a state's statutes or constitution. In *City of Montgomery v. Crossroads Land Co.*,[45] the Supreme Court of Alabama invalidated a regulation requiring either parkland dedication or payment of an in-lieu fee because the enabling statute, permitting regulations to provide for recreation spaces, did not specifically authorize in-lieu fees.[46] *City of Montgomery* provides a lesson to state legislatures: exaction schemes should grant broad powers for all types of exactions and then grant municipalities specific discretion to determine the appropriate type of exaction.[47]

In most cases, however, there is no express legislation at all, and municipalities rely on implied powers pursuant to, for example (as in Texas), a home rule amendment.[48] While some city governments may be concerned that aggressive regulation on the basis of such implied powers is too susceptible to legal challenges,[49] ultra vires objections to exaction schemes are becoming less frequent because of (i) clarified statutory authority,[50] (ii) the perceived appropriateness, in this era of impact and linkage fees, of charging fees in addition to established

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45. 355 So. 2d 363 (Ala. 1978).

46. *Id.* at 365 (cities not authorized to exact fees for local improvements). "[I]n the absence of legislative grant providing for a special source of revenue for public improvements, funds for that purpose are to be raised by an exercise of the power of general taxation." *Id.* (quoting City of Birmingham v. Wills, 59 So. 173, 175-76 (Ala. 1912)).

47. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 73 (1987). At least one state supreme court has interpreted legislative policy to authorize such discretion:

> Where a statute declares a legislative policy, establishes primary standards for carrying it out and lays down an intelligible principle to which an administrative body must conform, it may authorize the administrative body to fill in the details by prescribing rules and regulations for the enforcement of the statute.

Aunt Hack Ridge Estates v. Planning Comm'n, 273 A.2d 880, 883 (Conn. 1970)(validating parkland dedication ordinance). The Connecticut Supreme Court continued:

> "As the complexity of economic and governmental conditions increases, the modern tendency is liberal in approving broad regulatory standards so as to facilitate the operational functions of administrative boards or commissions."

Id. at 884 (quoting Forest Constr. Co. v. Planning & Zoning Comm'n, 236 A.2d 917, 923 (Conn. 1967)).

48. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 73 (1987).

49. *See id.* (discussing Middlesex & Boston St. Ry. v. Board of Aldermen, 359 N.E.2d 1279, 1282-83 (Mass. 1977)(invalidating home rule city's requirement that developer lease units to city housing authority for lack of statutory authority).

50. *See* Associated Home Builders v. City of Walnut Creek, 484 P.2d 606, 611 (Cal.)(en

dedication requirements,[51] and (iii) the tendency of some courts to imply authority for most exactions.[52]

2. Impermissible Taxation

Although authority to exact fees may be implied by enabling legislation, express statutory authority is required to impose taxes.[53] Consequently, if characteristics of a tax are present, a subdivision exaction can sometimes be successfully attacked by arguing that it is really a disguised tax. For example, regulatory fees must be used to finance specific services or facilities, while the purpose of a tax is to raise general revenues.[54] Therefore, in *Lafferty v. Payson City*,[55] the Utah Supreme Court struck down an impact fee ordinance, which charged $1,000 per dwelling unit, as an illegal tax because the fees were deposited into the city's general fund.[56] A fee may also be deemed a tax if the use of the funds does not sufficiently benefit the development paying the fee.[57] In *Town of Longboat Key v. Lands End, Ltd.*,[58] for ex-

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banc)(later statutory amendments conferred authority lacking in earlier invalidation cases), *appeal dismissed*, 404 U.S. 878 (1971).

51. *See* Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5, 10 (1987)(legal challenges to cash payments exacted in subdivision process often impaired by subsequent decisions permitting impact fees).

52. *See* Delaney, Gordon & Hess, *The Needs-Nexus Analysis: A Unified Test for Validating Subdivision Exactions, User Impact Fees and Linkage*, 50 LAW & CONTEMP. PROBS. 139, 146-47 (1987)(citing Savonick v. Township of Lawrence, 219 A.2d 903, 906 (N.J. Super. Ct. Law Div. 1966)(state constitution to be liberally construed to favor municipal authority)).

53. *See, e.g.*, Home Builders Ass'n v. Riddel, 510 P.2d 376, 378 (Ariz. 1973)(en banc)(taxing power of municipalities exists only to extent specifically conferred by charter or statute); Broward County v. Janis Dev. Corp., 311 So. 2d 371, 376 (Fla. Dist. Ct. App. 1975)(cities may impose taxes only if granted power by general law); *see also* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 74 (1987); Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 10 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

54. *See generally* Juergensmeyer & Blake, *Impact Fees: An Answer to Local Governments' Capital Funding Dilemma*, 9 FLA. ST. U.L. REV. 415, 422-27 (1981)(analysis of impact fees as taxes or valid land use regulations).

55. 642 P.2d 376 (Utah 1982).

56. *Id.* at 378 (reasonable charge for specific municipal service is permissible, but fees deposited in city's general fund constitute illegal tax).

57. Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 11 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

ample, the court invalidated an ordinance as an unauthorized, unconstitutional tax because there was no guarantee that the fees would benefit the burdened development.[59]

3. Constitutional Challenges

Even if an exaction scheme is expressly or impliedly authorized, the scheme may be subject to attack on federal or state constitutional grounds. A court may be asked to determine whether an ordinance is a valid exercise of the police power or constitutes a compensable taking under the fifth and fourteenth amendments. Because the fundamental authority for any exaction program is the police power, and because the police power customarily exists and is acknowledged, constitutional challenges generally focus on the reasonableness of the scheme.[60] Various tests for "reasonableness" have appeared in recent exactions cases.

a. Direct Benefit

The first standard of reasonableness can be termed the "strict need" or "direct benefit" test. Application of this test focuses on whether the fees paid as a condition to project approval directly benefit the project users or residents.[61] In the New York case of *Gulest Associates v. Town of Newburgh*,[62] an ordinance requiring payment of park and recreation fees that were passed into general revenues was found to be an unconstitutional taking because no direct benefits flowed to the burdened subdivision, even though the general revenues were available for playground and recreational purposes.[63]

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58. 433 So. 2d 574 (Fla. Dist. Ct. App. 1983).

59. *Id.* at 576.

60. *See generally* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 75 (1987)(introducing scope of judicial review). We will not discuss violations of procedural due process or equal protection principles, although such an analysis is helpful in some cases.

61. *Id.* at 75-76.

62. 209 N.Y.S.2d 729 (Sup. Ct. 1960), *aff'd*, 225 N.Y.S.2d 538 (App. Div. 1962). *Gulest* was expressly overruled in *Jenad, Inc. v. Village of Scarsdale*, 218 N.E.2d 673, 675 (N.Y. 1966), because the restrictiveness of the "direct benefit" test made it difficult to maintain.

63. *See* Gulest, 209 N.Y.S.2d at 733. *See generally* Delaney, Gordon & Hess, *The Needs-Nexus Analysis: A Unified Test for Validating Subdivision Exactions, User Impact Fees and Linkage*, 50 LAW & CONTEMP. PROBS. 139, 155-56 (1987)(discussing *Gulest*).

b. Specifically Attributable

A second standard of reasonableness, termed the "specifically and uniquely attributable" test, has been applied in Illinois, Rhode Island and New Hampshire.[64] This standard is illustrated in *Pioneer Trust & Savings Bank v. Village of Mount Prospect*.[65] An ordinance requiring dedication of land for schools was found to be a taking, and not a reasonable exercise of police power, because the need for additional schools existed prior to the creation of the new developments that were being ordered to dedicate land for schools. The need for additional schools was not, therefore, specifically and uniquely attributable to such new developments.[66] Significantly, however, the court implied that a proportionate contribution by developers seeking approval of new projects would not have constituted a taking.[67]

c. Rational Nexus

The direct benefit and specifically attributable tests place municipalities in somewhat of a bind where the "strain on infrastructure results from the cumulative effect of several developments in the recent past rather than the simple presence of a single development."[68] Because of the difficulty of showing direct benefits or specific attribution, a majority of jurisdictions now follow a third standard termed the "rational nexus" test.[69] In *Jordan v. Village of Menomonee Falls*,[70]

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64. *See, e.g.*, Rosen v. Village of Downers Grove, 167 N.E.2d 230 (Ill. 1960); J.E.D. Assocs. v. Town of Atkinson, 432 A.2d 12 (N.H. 1981); Frank Ansuini, Inc. v. City of Cranston, 264 A.2d 910 (R.I. 1970).

65. 176 N.E.2d 799 (Ill. 1961).

66. *Id.* at 802.

67. *Id.* ("[T]he school problem which allegedly exists here is one which the subdivider should not be obliged to pay the total cost of remedying . . . ."). Interpreting this statement in *Pioneer Trust*, one commentator stated, "Presumably, a proportionate contribution would not have constituted a taking." Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 76 n.33 (1987). In *Krughoff v. City of Naperville*, 369 N.E.2d 892, 895 (Ill. 1977), decided after *Pioneer Trust*, the Illinois Supreme Court found another exaction scheme for school and park sites valid under the "uniquely attributable" test.

68. Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 76 (1987).

69. *See, e.g.*, Associated Home Builders v. City of Walnut Creek, 484 P.2d 606, 612 (Cal.)(en banc), *appeal dismissed*, 404 U.S. 878 (1971); Land/Vest Properties v. Town of Plainfield, 379 A.2d 200, 204 (N.H. 1977); Longridge Builders v. Planning Bd., 245 A.2d 336, 337 (N.J. 1968); Amherst Builders Ass'n v. City of Amherst, 402 N.E.2d 1181, 1184 (Ohio 1980); Banberry Dev. Corp. v. South Jordan City, 631 P.2d 899, 902 (Utah 1981); Jordan v. Village of Menomonee Falls, 137 N.W.2d 442, 447-48 (Wis. 1965), *appeal dismissed*, 385 U.S. 4

the need for dedication of land or in-lieu fee payments for educational and recreational purposes was not directly attributable to a single development, nor would a facility constructed using the dedicated land or fees paid benefit only a single development. The court concluded that the exaction would nevertheless be valid where a *reasonable proportion* of the benefits of a facility flowed to residents of a contributing project.[71]

Some commentators feel that the rational nexus test is fair to both municipalities and developers and should be the framework for future analyses.[72] The initial step in the rational nexus inquiry is a determination of whether, and to what extent, the need for the additional facility or service is created by the assessed development.[73] If no formula or method of calculating the proportion of needs created by, and the share of costs to be assessed against, a new development exists, the ordinance may be subject to invalidation.[74] The second step in the inquiry is a determination of whether the assessed development benefits to a sufficient degree from the funds collected.[75] To ensure such benefits, courts may require that the funds be earmarked to a

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(1966); Wald Corp. v. Metropolitan Dade County, 338 So. 2d 863, 868 (Fla. Dist. Ct. App. 1976), *cert. denied*, 348 So. 2d 955 (1977).

70. 137 N.W.2d 442 (Wis. 1965), *appeal dismissed*, 385 U.S. 4 (1966).

71. *See id.* at 447-48 (cumulative effect of group of subdivisions approved in recent years may justify land dedication for recreational and educational purposes).

72. *See* Connors & High, *The Expanding Circle of Exactions: From Dedication to Linkage*, 50 LAW & CONTEMP. PROBS. 69, 77 (1987)(development's residents should pay only for improvements reasonably related to developmental impacts on infrastructure and from which development's residents will derive benefit).

73. Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 14 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

74. *See* Longridge Builders v. Planning Bd., 245 A.2d 336, 337 (N.J. 1968)(city may not require subdivider to pave dedicated road because ordinance does not prescribe method of apportioning cost based on needs created by subdivision); *see also* Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 14 nn.123-24 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law). See generally *Land/Vest Properties v. Town of Plainfield*, 379 A.2d 200, 205 (N.H. 1977) and *Banberry Development Corp. v. South Jordon City*, 631 P.2d 899, 903-04 (Utah 1981), where the courts suggest criteria for evaluating the developer's proportionate or fair share of the costs of capital facilities.

75. Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 14 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

particular account and either spent or refunded within a reasonable time.[76]

d. Other Tests

Several other tests for constitutionality have been identified by land use scholars and practitioners, some of which are variations of the above three standards. The "judicial deference" test "provides for the automatic acceptance of a legislative determination in favor of an exaction, unless the developer produces evidence demonstrating that the exaction is unreasonable."[77] Another criterion, termed the "reasonable relationship" test (also the "anything goes," or California, rule), results in a consideration of "whether the proposed development will contribute to the problem sought to be alleviated by imposition of the regulation."[78] Finally, a "needs-nexus" test has been proposed as a consolidation of existing tests, adapted to fit the complex issues presented by growing use of impact fees and linkage.[79]

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76. *See* Amherst Builders Ass'n v. City of Amherst, 402 N.E.2d 1181, 1184 (Ohio 1980)(fees for connecting to existing sewer system must be earmarked to specific sewer fund).

77. Delaney, Gordon & Hess, *The Needs-Nexus Analysis: A Unified Test for Validating Subdivision Exactions, User Impact Fees and Linkage*, 50 LAW & CONTEMP. PROBS. 139, 154-55 (1987)(citing Billings Properties v. Yellowstone County, 394 P.2d 182, 185-86 (Mont. 1964)(presumption in favor of exaction)).

78. *Id.* at 148-49 (citing Ayres v. City Council of Los Angeles, 207 P.2d 1, 5 (Cal. 1949) and several cases applying *Ayers*). This test requires that the exactions bear some reasonable relationship to the needs generated by the development. *See* Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspective*, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 12 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law). Judicial deference and a loose standard of reasonableness make this test "an almost insurmountable obstacle for a developer to overcome." *Id.*; *see also* Associated Home Builders v. City of Walnut Creek, 484 P.2d 606, 611 (Cal.)(en banc)(exaction for recreational facilities justified by general public need created by present and future subdivisions), *appeal dismissed*, 404 U.S. 878 (1971). *But see, e.g.*, Nollan v. California Coastal Comm'n, __ U.S. __, __, 107 S. Ct. 3141, 3148, 97 L. Ed. 2d 677, 689 (1987)(restriction must serve legitimate state interest); *infra* text accompanying notes 81-87.

79. *See* Delaney, Gordon & Hess, *The Needs-Nexus Analysis: A Unified Test for Validating Subdivision Exactions, User Impact Fees and Linkage*, 50 LAW & CONTEMP. PROBS. 139, 157-65 (1987)(analysis of the needs-nexus test). Under this test, the need for the exaction must be generated by or result from the assessed development. Further, courts are advised to review impact fees and linkage (as opposed to traditional subdivision exactions) under a higher level of scrutiny, whereby the burden of proof would be on the government to prove that less intrusive alternatives are not available. *Id.* However, while the needs-nexus test would require that a traditional subdivision exaction be reasonably related to a legitimate state interest, the test would not require that a compelling governmental interest be shown in the case of impact fees and linkage. *See* Taub, *Exactions, Linkage and Regulatory Takings: The Developer's Perspec-*

D. Nollan v. California Coastal Commission

On the last day of its 1987 term, the United States Supreme Court decided a case that both limits imposition of and confirms the validity of impact fees and dedications. *Nollan v. California Coastal Commission*[80] involved a claim by a beachfront property owner that the required dedication of a public access easement as a condition for a building permit constituted a compensable taking.[81] The Supreme Court first noted that outright imposition of such an easement (unrelated to a building permit request) would constitute a taking.[82] The Court then considered whether the same requirement in conjunction with a building permit request is a permissible exercise of the police power.[83]

Citing earlier Supreme Court cases, Justice Scalia acknowledged that "land use regulation does not effect a taking if it 'substantially advances legitimate state interests' and does not 'deny an owner economically viable use of his land.' "[84] Even assuming a legitimate interest in providing public access to the beach, however, the Court failed to find an essential "nexus" between the public access easement condition imposed to further that interest and the landowner's building proposal—that is, refusing to grant a building permit would not increase beach access, and permitting the building would not make access more difficult.[85] The Court noted, however, that a height or width restriction to preserve visual access to the beach conceivably could satisfy constitutional requirements.[86]

Significantly for the present analysis, the Court appears to have adopted the "rational nexus" test for exactions. Even where a public need exists, and even given that a municipality is authorized under its police power to regulate land use in the public interest, there must be a substantial relationship between what is exacted from a landowner

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tive, in PROPERTY RIGHTS UNDER THE CONSTITUTION: ARE THERE ANY LEFT? § C, at 41-42 & n.391 (1987)(program materials for American Bar Association meeting, section of Real Property, Probate and Trust Law).

80. __ U.S. __, 107 S. Ct. 3141, 97 L. Ed. 2d 677 (1987).

81. *See id.* at __, 107 S. Ct. at 3144, 97 L. Ed. 2d at 684.

82. *See id.* at __, 107 S. Ct. at 3145, 97 L. Ed. 2d at 685 (appropriation of public easement more than mere restriction on use of private property).

83. *Id.* at __, 107 S. Ct. at 3146, 97 L. Ed. 2d at 687.

84. *Id.* (quoting Agins v. City of Tiburon, 447 U.S. 255, 260 (1980), and citing Penn Central Transp. Co. v. New York City, 438 U.S. 104, 127 (1978)).

85. *See id.* at __, 107 S. Ct. at 3148, 97 L. Ed. 2d at 689.

86. *See id.* at __, 107 S. Ct. at 3147-48, 97 L. Ed. 2d at 689.

and the public needs or burdens generated by the landowner. Therefore, regulatory schemes that impose fees, dedication requirements, or other conditions on development in order to support unrelated public projects or needs—e.g., linkage programs to build hospitals, libraries, etc.—will probably not meet the nexus requirement set forth in *Nollan*. While there may be no question that a city needs low-cost housing, public transit, or day care facilities, the important question is whether such needs are in fact caused by new development.

E. *Guidelines for Analysis*

"[W]e never know where the police power ends."[87]

Malcolm Misuraca recently analogized the demarcation between the permissible extent of the police power and its excesses to the *limu* line—a Hawaiian term for "the meandering, shifting line along the beach of bits and pieces of drift wood [and] jettisoned goods . . . ."[88] Mr. Misuraca noted at the conclusion of the 1985 Duke University Law School Symposium on Exactions that the speakers "betrayed more uneasiness over fundamentals than one might have expected from so much experience."[89] Uncertainty and unhappiness over the increasing use of exactions were not only mentioned by several speakers,[90] but are characteristic of developers everywhere. While tests and standards for the validity of exactions exist, and are often the subject of lawsuits and judicial opinions, the particularity of the facts in most cases, as well as the continuing evolution of both the law and the growth-financing methods of municipalities, make conclusions difficult. Striking variations appear in the numerous state court opinions concerning the legitimate use of and limits upon municipal exactions. *Nollan*, however, may be the landmark decision that will bring some uniformity to judicial analyses of municipal exaction schemes.

Although this evolution likely has not yet run its course, the foregoing overview suggests that analysis of a suspect exaction scheme should proceed generally as follows:

1. *Authority*. Is the municipality or other governmental entity authorized, under state statutes or the constitution, or under home rule

87. Misuraca, *Summation* to *Exactions: A Controversial New Source for Municipal Funds*, 50 LAW & CONTEMP. PROBS. 167, 167 (1987).

88. *Id.*

89. *Id.*

90. *Id.* at 168.

powers, to impose such an exaction on new development, and was the exaction properly enacted?

2. *Impermissible Tax.* Is the exaction in reality a disguised tax, oriented to increasing general revenues and not restricted to financing improvements caused by and benefitting the new development?

3. *Rational Nexus.* Is there a direct relationship between the new development, the public need, and the exaction program adopted? Elements of this inquiry include:

a. Is the public need caused by the new development, at least in part?

b. Is the share of costs assessed to the new development proportionate to the needs caused by the development, and is the development's cost share determined pursuant to a workable formula?

c. As to a monetary exaction, is it collected and set aside, and spent within a reasonable period of time, to complete improvements identified as necessitated by and benefitting the new development?

The above analysis is consistent with the rationale in *Nollan*, and provides a methodology aimed at producing a result which is fair to both developers and municipalities. *Nollan* may foreshadow a beginning to the end of the radical division of perspective between municipal planners, who must somehow finance capital improvements, and developers, who feel that they often must bear more than their fair share of municipal financial burdens.

III. THE TEXAS EXPERIENCE

A. *Subdivision Development Conditions*

As already noted, it is well-established in Texas that municipalities have the right to impose conditions on subdivision development. A developer may be required to "donate" on-site alleys, streets, drains, sewer mains, water mains and the like to the municipality as a condition for certain use of property or subdivision of land.[91] Such donation requirements are viewed as a reasonable exercise of governmental discretion and as regulation not amounting to the taking of private property for public use without just compensation.[92] As a result, subdivision and land regulation ordinances in many Texas cities require

91. Crownhill Homes v. City of San Antonio, 433 S.W.2d 448, 460 (Tex. Civ. App.—Corpus Christi 1968, writ ref'd n.r.e.)(weight of authority overwhelming that such donation not a taking).

92. *Id.*

dedication and construction of such improvements, or the payment of fees in lieu thereof, as a condition for the approval of a subdivision plat or other development permits.[93]

B. *Parkland Dedication and In-Lieu Fees*

Texas courts have not yet considered the authority of municipalities to impose, or the validity of, impact fees. However, some Texas municipalities have begun to require the dedication of somewhat less than essential facilities as a condition of subdivision development. Before considering Texas's recently enacted impact fee statute, we will review the two most significant and recent Texas judicial decisions on the subject of exactions, both of which concern parkland dedication and fees in lieu thereof.

1. *Berg* and *Turtle Rock*

In *Berg Development Co. v. City of Missouri City*,[94] a case of first impression in Texas,[95] the developer of a residential subdivision challenged the constitutionality of a Missouri City, Texas, ordinance requiring dedication of a portion of his development for public park purposes. The ordinance permitted payment of a fee in lieu of such dedication in an amount equal to the fair market value of the acreage that would otherwise be donated.[96] The Houston Court of Civil Appeals viewed the entire notion of parkland dedication requirements as an unconstitutional taking without adequate compensation,[97] holding that "[w]hile government can clearly require the dedication of watermains and sewers as well as property for streets and alleys, . . . the dedication of property for recreational purposes" is not a proper exercise of the police power.[98]

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93. *See, e.g.*, AUSTIN, TEX., CODE ch. 13-3 (1981).

94. 603 S.W.2d 273 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.).

95. *Id.* at 274.

96. *Id.*

97. *See id.* at 274-75 (citing TEX. CONST. art. I, § 17). The Texas Constitution states in pertinent part: "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made . . . ." TEX. CONST. art. I, § 17.

98. Berg, 603 S.W.2d at 275 (streets, sewers, etc., are substantially related to community health and safety, but park areas are not). *But see* Note, *Municipal Ordinance Requiring Parkland Dedication as a Condition to Subdivision Plat Approval Held Not Unconstitutional Per Se:* City of College Station v. Turtle Rock, Corp., 16 TEX. TECH. L. REV. 1015, 1022 & n.67 (1985)(*Berg* placed Texas against great weight of authority concerning parkland dedication); *infra* text accompanying notes 111-15.

In *City of College Station v. Turtle Rock Corp.*,[99] the Texas Supreme Court reviewed the constitutionality of a College Station, Texas, ordinance requiring parkland dedication (or money in lieu thereof) as a requirement for subdivision plat approval. The trial court found the ordinance unconstitutional, and the Houston Court of Appeals affirmed, relying on the "per se" unconstitutional rule in *Berg*.[100] The Texas Supreme Court reversed and remanded, holding that the parkland dedication ordinance was not constitutionally invalid per se and was "not inherently different from other types of municipal land use regulations such as density controls and street dedication requirements."[101] The court distinguished *Berg*, agreeing that the Missouri City ordinance was "arbitrary and therefore unreasonable and unconstitutional,"[102] but indicated that parkland dedication requirements, properly structured and limited, could be a valid and constitutional exercise of the police power.[103]

2. A Test for the Constitutionality of Parkland Dedication Requirements

A city may, under the police power, enact reasonable regulations to promote public health, safety and the general welfare,[104] and "all property is held subject to the valid exercise of the police power."[105] At the same time, the Texas Constitution requires that adequate compensation be paid when private property is taken for public use.[106] A compensable taking does not, however, arise for losses occasioned by the proper and reasonable exercise of police power unless (i) the regulated property is rendered useless, (ii) the regulation causes a property loss not common to other landowners, or (iii) property is taken for the

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99. 680 S.W.2d 802 (Tex. 1984). *See generally* Note, *Municipal Ordinance Requiring Parkland Dedication as a Condition to Subdivision Plat Approval Held Not Unconstitutional Per Se:* City of College Station v. Turtle Rock, Corp., 16 TEX. TECH. L. REV. 1015 (1985).

100. *See* Turtle Rock, 680 S.W.2d at 804-05 (citing City of College Station v. Turtle Rock, Corp., 666 S.W.2d 318, 322 (Tex. App.—Houston [14th Dist.] 1984)).

101. *Id.* at 806.

102. *Id.* at 805 (Missouri City ordinance did not limit use of funds to assessed development).

103. *See id.* at 805-07; *see also infra* text accompanying notes 112-16.

104. Ellis v. City of W. Univ. Place, 141 Tex. 608, 610, 175 S.W.2d 396, 397 (1943); *see also supra* text accompanying notes 9-14.

105. Lombardo v. City of Dallas, 124 Tex. 1, 10, 73 S.W.2d 475, 478 (1934).

106. *See* TEX. CONST. art. I, § 17.

government's own advantage.[107]

Recognizing the illusory nature of any attempt to establish a bright line distinction between a proper exercise of police power and a compensable taking of private property,[108] the Texas Supreme Court concluded in *Turtle Rock* that "ultimately a fact-sensitive test of reasonableness is required."[109] The court delineated two related requirements for the valid exercise of a city's police power: "First, the regulation must be adopted to accomplish a legitimate goal; it must be 'substantially related' to the health, safety, or general welfare of the people. Second, the regulation must be reasonable; it cannot be arbitrary."[110]

As regards the first requirement, the court in *Turtle Rock* found the concept of "the public welfare" to have "a broad range."[111] Citing as persuasive authority the numerous cases in other jurisdictions which have upheld parkland dedication ordinances as legitimate exercises of the police power,[112] the court ruled that "[t]he court of appeals erred in holding that, as a matter of law, a requirement for dedication of park land does not bear a substantial relation to the health, safety, or general welfare of the community."[113] Limiting *Berg* to its facts, the court concluded that the Missouri City ordinance was arbitrary and unreasonable because the ordinance permitted the exaction of funds from a developer which might never be used to benefit the developer's subdivision.[114] Remanding the case, the court directed that the College Station ordinance be tested under this "arbitrary and unreasonable" standard.[115]

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107. City of Austin v. Teague, 570 S.W.2d 389, 391-93 (Tex. 1978)(synthesis of Texas cases distinguishing valid exercise of police power and taking by eminent domain).

108. *See* City of College Station v. Turtle Rock, Corp., 680 S.W.2d 802, 804 (Tex. 1984). Earlier, the Texas Supreme Court noted that the doctrines embodied by the labels "police power" and "eminent domain" "merge at so many places when applied to specific problems, that the legal battlefields have been variously termed a 'sophistic Miltonian Serbonian Bog'; a 'crazy-quilt pattern'; 'the manifest illusoriness of distinctions'; producing decisions that are 'conflicting, and often . . . irreconcilable in principle.' " Teague, 570 S.W.2d at 391 (citations omitted).

109. Turtle Rock, 680 S.W.2d at 804.

110. *Id.* at 805 (citations omitted).

111. *Id.*

112. *See id.*

113. *Id.*

114. *See id.* (ordinance constituted special economic burden on developer and home buyers without guaranteeing benefit therefrom).

115. *See id.* at 808.

3. *Nollan* and the Standard for Review

Texas courts generally apply a highly deferential standard of review to municipal ordinances. "A city ordinance is presumed to be valid, and . . . the courts have no authority to interfere unless the ordinance is unreasonable and arbitrary—a clear abuse of municipal discretion";[116] therefore, an "extraordinary burden" rests on the challenger of such an ordinance.[117] Judicial deference has been particularly pronounced in zoning cases. In *Shelton v. City of College Station*,[118] for example, the United States Court of Appeals for the Fifth Circuit noted that under Texas law the "outside limit upon a state's exercise of its police power in zoning decisions is that they must have a rational basis,"[119] and *any* conceivable rational basis will suffice.[120]

The *Nollan* decision, however, requires a higher standard of review in cases involving regulatory takings claims. Emphasizing the language in *Agins v. City of Tiburon*[121] that a regulation must "substantially advance" a legitimate state interest to avoid characterization as a compensable taking, the majority in *Nollan* reviewed the regulatory action at issue to determine if it substantially advanced the public interest sought to be achieved and found that it did not.[122] The Court rejected the suggestion by the dissent that the Court's review should be limited to ascertaining whether the state could rationally have decided that the measure adopted might achieve the state's objective.[123] Rather, the Court declared that a land use regulation must be scrutinized to assure that the "essential nexus"—that is, that the regulation "substantially" advances the state's objective—exists.[124]

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116. Hunt v. City of San Antonio, 462 S.W.2d 536, 539 (Tex. 1971).

117. *Id.* (presumption disappears if arbitrary and unreasonable action shown).

118. 780 F.2d 475 (5th Cir. 1986).

119. *Id.* at 482.

120. *Id.* at 477 (citing Vance v. Bradley, 440 U.S. 93, 111 (1979)(emphasis added)). "[A]n ordinance [is] not to be declared unconstitutional unless 'clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare.' " *Id.* at 479-80 (quoting Moore v. City of E. Cleveland, 431 U.S. 494, 498 n.6 (1977)). As regards a specific zoning (property rights) decision, in which there is a greater likelihood of encountering protected property interests, a procedural due process inquiry might require the decision maker to point to a particular rational basis which was employed in reaching the decision.

121. 447 U.S. 255 (1980).

122. *See* Nollan v. California Coastal Comm'n, __ U.S. __, __, 107 S. Ct. 3141, 3146-48, 97 L. Ed. 2d 677, 687-89 (1987)(citing Agins v. City of Tiburon, 447 U.S. 255, 260 (1980)).

123. *See id.* at __ n.3, __, 107 S. Ct. at 3147 n.3, 3150, 97 L. Ed. 2d at 688 n.3, 691-92.

124. *See id.* at __, 107 S. Ct. at 3150, 97 L. Ed. 2d at 692.

It is difficult to square this higher standard of review with the *Turtle Rock* decision.[125] The Texas Supreme Court in *Turtle Rock* held that the relationship of the College Station ordinance to the health, safety or general welfare of the community was a matter "about which reasonable minds might differ,"[126] and "[i]f reasonable minds may differ as to whether or not a particular zoning ordinance has a substantial relationship to the public health, safety, morals, or general welfare, . . . the ordinance must stand as a valid exercise of the city's policy [sic] power."[127] This "any rational basis" approach is inconsistent with the higher level of scrutiny now required under *Nollan* for regulatory exactions, which assures a proper connection between a public need for which the exaction is made and the development being charged with the exaction. On the other hand, the second step in the *Turtle Rock* test, determining whether the regulation is reasonable and not arbitrary,[128] fits the "essential nexus" requirement described in *Nollan*.[129] The "reasonable connection" analysis set forth in *Turtle Rock*, with its review of the connection (or "nexus") between the increased park and recreation needs created by the new subdivision and the exaction imposed and the benefits conferred upon it,[130] is intended to satisfy this requirement.

4. The Texas Rule After *Nollan*

The foregoing analysis suggests that in Texas exaction formulas of any kind must meet the following criteria to pass constitutional muster:

(a) As long as land is not developed, the city can require no exaction. The exaction is a regulatory response to needs created by the developer's use of land, and there must be a "use" before regulation of the use through exactions may occur.[131]

(b) There must be a reasonable connection between the effects of the development and the claimed need for increased public services.[132]

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125. *See supra* text accompanying note 110.

126. City of College Station v. Turtle Rock, Corp., 680 S.W.2d 802, 805 (Tex. 1984).

127. *Id.* (quoting Hunt v. City of San Antonio, 462 S.W.2d 536, 539 (Tex. 1971)); *see also supra* text accompanying notes 116-17.

128. *See supra* text accompanying note 110.

129. *See supra* text accompanying notes 122-24.

130. *See* City of College Station v. Turtle Rock, Corp., 680 S.W.2d 802, 805-07 (Tex. 1984).

131. *Id.* at 806.

132. *Id.*

(c) The exaction must be reasonable in amount, based on the increased public services necessitated by the development.[133]
(d) There must be a reasonable connection between the funds collected or lands dedicated and the benefits accruing to the assessed development.[134]
(e) All funds collected or lands dedicated must be used only for the needed increased public services, and they must be so used within a reasonable time period.[135]

C. *The 1987 Impact Fee Act*

Although there have been no recent Texas cases involving impact fees, the Texas Legislature has recently passed an important impact fee statute. The 1987 Impact Fee Act[136] (the "Act") is a comprehensive piece of legislation that establishes the standards and procedures by which municipalities and other governmental entities in Texas may impose impact fees on new development. The Act is designed to create an ordered, predictable process for the consideration, adoption and assessment of impact fees. It contemplates initial and continual public scrutiny; requires thorough research, analysis and data-based justification and quantification prior to the imposition of any impact fee; defines a limited array of capital improvements which may be funded by such fees; and demands rigid accountability for the expenditure of fees collected.[137] Quite clearly, the Act is intended to place careful controls upon the imposition and use of impact fees in Texas and is an attempt to codify some of the constitutional standards discussed above.

Under the Act, impact fees may be assessed against new development only in order to fund the cost of capital improvements or facility expansions necessitated by and attributable to such new development.[138] The types of improvements which can be paid for by impact fees are limited to roads and water, wastewater and drainage facili-

133. *See supra* text accompanying notes 73-74.
134. Turtle Rock, 680 S.W.2d at 805-07.
135. *Id.* at 805-06.
136. Act of June 20, 1987, ch. 957, §§ 1-12, 1987 Tex. Sess. Law Serv. 6519 (Vernon)(codified at TEX. REV. CIV. STAT. ANN.. art. 1269j-4.11 (Vernon Supp. 1988)). The Act, hereinafter referred to as the "1987 Impact Fee Act" or the "Act," was effective June 20, 1987.
137. *See generally* TEX. REV. CIV. STAT. ANN. art. 1269j-4.11 (Vernon Supp. 1988)(Act sets out detailed provisions municipalities must follow to impose impact fees).
138. *Id.* § 1(4)(A).

ties.[139] Public parks and certain other municipal projects may not be funded by impact fees.[140] Impact fees may be collected and expended only in accordance with a professionally prepared capital improvements plan that empirically establishes the service demands necessitated by and attributable to the new development upon which the fees are to be imposed, and the impact fees so assessed must be proportionate to the service demands attributable to the new development.[141] The Act further requires a municipality imposing an impact fee to update its land use assumptions and capital improvements plan at least every three years.[142]

Impact fee proceeds must be segregated from general municipal funds and deposited in interest-bearing accounts that clearly identify the category of capital improvements or facility expansions for which the fee was assessed.[143] Impact fee revenues may be spent only for the purposes for which the fee was imposed,[144] and revenues not expended within a prescribed period of time must be refunded.[145]

The Act also provides for notice and public hearings prior to the levying of an impact fee.[146] It requires the appointment of a committee, the members of which must include representatives of the real estate, development or building industries, to perform extensive advisory functions for the municipality in the areas of land use, capital improvements, and impact fees.[147] All impact fees in place on the effective date of the Act must be replaced within three years by an impact fee enacted pursuant to the provisions of the Act,[148] and no moratorium may be placed on new developments for the purpose of awaiting the completion of all or any part of the process necessary to

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139. *See id.* § 1(2).

140. *See id.* § 1(4)(B).

141. *See id.* § 2(d)(1). Under some circumstances, a developer's expenditures for "capital improvements or facility expansions . . . will be credited against the impact fees otherwise due from the new development . . . ." *Id.* § 2(h)(2).

142. *See id.* § 6. Section 6 outlines the procedures a municipality must follow to update its plan.

143. *Id.* § 4(a).

144. *Id.*

145. *See id.* § 5(c) (any portion of impact fee not used within ten years of payment date must be refunded); *see also id.* § 5(a) (permitting earlier refund upon property owner's request in some circumstances).

146. *See generally id.* § 3.

147. *See id.* §§ 3(c), 7. An existing planning or zoning commission may act as this advisory committee under certain circumstances. *See id.* § 7(a).

148. *Id.* § 8(d).

develop, adopt or update an impact fee.[149] An individual who has exhausted all administrative remedies and is aggrieved by a final decision concerning an impact fee may appeal and is entitled to a trial de novo.[150]

D. *Issues for the Near Future*

Through the Act, the Texas Legislature has curtailed what public planning officials and consultants have considered a fertile and largely unregulated source of municipal revenues. The Act and the decisions in *Turtle Rock* and *Nollan* seem compatible, and Texas developers may now enjoy some predictability regarding, and restriction of their exposure to, impact fee assessments. Developers and their lenders, therefore, should review the Act in detail, paying particular attention to (i) the variations in application of the Act that depend upon the date on which affected land was platted or the date on which impact fees were adopted,[151] and (ii) the general provisions prohibiting moratoria and requiring that existing impact fees be replaced within three years.[152] Additionally, developers and lenders should be on the alert for new impact fee programs to ensure that the required procedures for the adoption thereof are followed[153] and that such programs are otherwise consistent with constitutional and statutory requirements.

Financial pressures on Texas cities have not lessened, however, and revenue sources never seem to increase sufficiently to keep pace with demand for city services. In the near term, therefore, one can expect Texas municipalities to propose various expansions of the Act, particularly in regard to the types of improvements and/or services which may be funded by impact fees.[154] Also, municipalities may try to create a new classification or characterization of exactions to side-step the restrictions of the Act. For example, in California, a state which like Texas provides for broad municipal home rule powers, a "special assessment" scheme has been devised to impose charges on particular

149. *Id.* § 8(f).
150. *Id.* § 9.
151. *See id.* § 2(e).
152. *See id.* § 8(d), (f).
153. *See generally id.* § 3.
154. Given the encouraging language of *Turtle Rock*, dedication of parkland would seem to be a logical initial attempt at expansion of the scope of impact fees under the Act. Look also for attempts to include police, fire and emergency health services as proper subjects of impact fee assessments.

real property for local public improvements of direct benefit to that property.[155] The City of San Diego utilized this concept in adopting a "fixed benefit assessment" technique to finance public improvements, allocating such assessments to each undeveloped parcel of land in a designated "fixed benefit area."[156] This "fixed benefit assessment" is used to finance many public improvements which have traditionally been financed out of general revenues, including transit and transportation, libraries, fire and police stations, and schools.[157]

Finally, one should never underestimate the resilience and flexibility of the police power as the basis for new development exactions. The observation in *Village of Euclid v. Ambler Realty Co.*[158] some sixty years ago may be even more apt now:

> Until recent years, urban life was comparatively simple; but with the great increase and concentration of population, problems have developed, and constantly are developing, which require, and will continue to require, additional restrictions in respect of the use and occupation of private lands in urban communities. Regulations, the wisdom, necessity and validity of which, as applied to existing conditions, are so apparent that they are now uniformly sustained, a century ago, or even half a century ago, probably would have been rejected as arbitrary and oppressive.[159]

IV. EPILOGUE: SUGGESTIONS FOR LENDERS

Mortgage lenders typically require voluminous information concerning a project prior to closing a real estate-secured loan. Loan officers are also trained to ensure that an accurate budget is submitted by developers during loan negotiations. Consequently, lenders have learned to recognize and deal with traditional dedication and fee requirements. In this section, we will focus particularly on the concerns

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155. *See* Solvang Mun. Util. Dist. v. Board of Supervisors, 112 Cal. App. 3d 545, 557, 169 Cal. Rptr. 391, 398 (Ct. App. 1980).

156. The "fixed benefit assessment" technique is discussed in *J.W. Jones Cos. v. City of San Diego*, 157 Cal. App. 3d 745, 203 Cal. Rptr. 580 (Ct. App. 1984).

157. Smith, *From Subdivision Improvement Requirements to Community Benefit Assessments and Linkage Payments: A Brief History of Land Development Exactions*, 50 LAW & CONTEMP. PROBS. 5, 20-21 (1987). For a discussion of the San Diego fixed benefit assessment scheme in general and of the *Jones* case particularly, see generally *id.* at 20-24.

158. 272 U.S. 365 (1926).

159. *Id.* at 386-87.

of a mortgage lender facing the growing, and often novel or creative, use of exactions by municipalities.

A. *Understanding the Borrower's Dilemma*

Borrowers faced with aggressive impact fee schemes (or even linkage fees) in addition to traditional dedication and infrastructure construction requirements, as conditions to approval of their projects, must decide whether to challenge such schemes or simply accept the financial burdens imposed thereby. A challenge often is uncertain in result and, given the costs and time required, uneconomical. Lenders should determine early in the loan negotiation process the type and extent of exactions either imposed or contemplated by the governmental entities having jurisdiction over the project and the borrower's perspective on them.

If the local government regulating the project has enacted a burdensome exaction scheme that appears to be unauthorized or unconstitutional, the lender may consider supporting a challenge by the borrower to the regulation. Even if a lender does not want to provide litigation funds, it may be willing to join an action as a plaintiff or at least offer moral support. Additionally, a lender may want to organize or join in deliberations regarding the replacement or creation of new impact fee regulations pursuant to the Act and in industry-wide efforts to support creation of uniform or model exaction legislation and ordinances.

B. *Effect on Collateral*

The information-gathering role of the lender is already established in practice, and most lenders follow extensive checklists to aid them in assessing the viability of a development. Delivery by the borrower, and review by the lender and its counsel, of a complete schedule of existing and potential exactions should clearly be a checklist item. On every project loan, but especially for development and construction projects that will span years and several phases, a mortgage lender and its counsel should inquire about the governmental approvals and permits that have been obtained and those that will be required, any agreements and commitments made by the borrower for contributions to on-site and off-site improvements, and the local and statewide plans and possibilities for exaction programs. Since impact fee regulations are almost always local in origin and site specific, lenders should en-

sure that their review is appropriately focused on the actual project location and the municipal exaction practices applicable to it.

Lenders typically require copies of all agreements entered into between a developer and governmental authorities, and usually require collateral assignment of the rights under such agreements. Since the secured lender may someday need to own or to control the project, a new level of scrutiny may now be required concerning what obligations are associated with developer agreements, whether the benefits of such agreements can be utilized by successor owners, such as a lender or its assigns, and whether a lender can avoid unwanted obligations. In some cases, a lender will want to ensure that the development rights associated with exaction payments will be preserved, or tied to the land. In other cases, the lender may want to ensure that borrower agreements and commitments contain an escape clause in case the lender takes over a project and does not want to be obligated to complete future phases of the project. Lenders may need to approach and work with municipal authorities to obtain an enforceable consent to assignment, to clarify the obligations and liabilities of an assignee, and to ensure that a successor owner will receive the benefit of any refunds, credits, offsets, licenses, permits, or approvals to be given to the borrower.

C. *Documentation*

Governmental approval and permitting of a project are typical concerns of a lender, both in requiring borrower representations and in obtaining collateral assignments of such approvals. While requirements for the payment of fees as a condition to such approvals are all too familiar to mortgage lenders, new attention should be given to whether all fees affecting the viability of a project have been paid, especially those fees unrelated to specific subdivision improvements.

Although a series of warranties and representations appears in virtually all loan agreements and deeds of trust, renewed attention to the standard provisions is appropriate as regards exactions. A representation (and perhaps a schedule or exhibit) concerning all dedications and infrastructure construction requirements, in-lieu fees, impact fees, and linkage requirements, as well as all developer agreements entered into in connection with the project, will serve to highlight the issue.

The agreements entered into between the borrower and a governing authority may be personal to the borrower and unassignable. Prior to closing the loan, a lender should determine whether the rights and/or

obligations under such agreements run with the land, or whether the lender is required to become a party to the agreement to ensure that the benefits will accrue upon foreclosure to the successful bidder. Obligations that run with the land should be evaluated to determine whether the lender or others will be required to make payments upon foreclosure.

Prohibitions against the borrower entering into future development agreements or commitments without the lender's consent become more important in this new era of impact fees. A lender may want to establish a direct relationship with local governmental authorities concerning real estate pledged as collateral, and request notices from the local authorities, and possibly a veto power, as to any development agreements arising after the loan is made.

Greater attention also is needed in connection with the budget submitted by the borrower. The final budget should identify and show a method of handling all contemplated development costs, including exactions and other charges that may not appear to be directly related to the project, as well as the total cost, not just the initial installment payment, of long-term obligations.

Finally, the new dependence of municipalities upon exactions is similar, from a lender's perspective, to the liabilities that arise when secured property is contaminated with hazardous waste.[160] Lenders are warned against foreclosure in such circumstances because they may become targets of liability for environmental clean-up efforts. Although the potential liabilities probably are not as great, lenders should be aware of the new types of exactions that are considered reasonable allocations of the cost of growth and are binding on and run with the land.

V. SUMMATION

Local governments are increasingly relying upon new forms of exactions to mitigate the costs of growth. While traditional on-site dedication and in-lieu fee requirements raise few legal issues, the more creative impact fee, special assessment, and linkage schemes enacted by some cities test the constitutional limits of land use regulation. Recent judicial opinions offer some guidance both to municipal planners

160. *See generally* Burcat, *Environmental Liability of Creditors under Superfund*, PRAC. LAW., Mar. 1987, at 13-24.

and to developers as to the characteristics of a valid exactions program. Texas's new impact fee statute authorizes cities to seek new revenue sources, but the statute also imposes extensive limitations on municipal power in an attempt to codify constitutional guidelines.

Mortgage lenders and their counsel need to consider the impact of exaction programs on their lending practices. Because a borrower's finances and the value of real property collateral are significantly affected by fees and dedications required under innovative municipal financing schemes, lenders must be aware of all existing and likely future programs of this sort. Additionally, renewed attention to loan documents is warranted to reflect the concerns of lenders with respect to the growing use of exactions.