

HOW BUYERS AND SELLERS OF DEVELOPMENT LAND DEAL WITH REGULATORY RISK

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Editors' Synopsis: Government regulation can impose a significant economic cost upon a proposed development project. This Article considers the lack of clarity with which the law allocates the risk of regulatory costs, and the author identifies specific areas that are appropriate for express contractual allocation of regulatory risk.

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When a builder contracts to purchase land for a development project and thereafter realizes that the proposed development project has diminished in value or become worthless because of unanticipated government regulations, the builder may seek to rescind the contract and obtain a refund of money paid to the seller.¹ This Article describes the conflicting legal standards that courts apply in these cases and offers language to aid a practitioner in drafting contracts that clearly apportion regulatory risk between a buyer and seller of development land.

I. THE CONFLICTING COMMON-LAW DEFAULT RULES

Consider the example of a homebuilder who purchases one hundred acres of riverfront land for development after extensive due diligence, reviewing local zoning and subdivision regulations. Three weeks after closing, the developer learns that the Army Corps of Engineers has just classified ten acres of the site immediately fronting the river as wetlands and intends to prohibit development of that part of the site. Aggravating the situation further, the city council votes to increase the local impact fee from \$1,000 per unit to \$15,000 per unit, based on a detailed study of the effects of new development on public facilities. The ordinances, statutes, or regulations permitting these governmental actions were in effect when the homebuilder entered the contract, but were applied to the homebuilder's

¹ Sellers rarely seek rescission for regulatory risk. *But see Garb-Ko, Inc. v. Lansing-Lewis Servs.*, 423 N.W.2d 355 (Mich. Ct. App. 1988) (stating that because of continuing responsibility imposed on sellers of contaminated land by environmental protection statutes, seller, after discovering contamination on property, was entitled to rescission of land sale agreement "[i]n order to contain further cleanup costs and third-party claims . . .").

land only after closing. Does the homebuilder have the right to rescind the sale without a contract provision clearly allocating this regulatory risk?

The rules governing the allocation of regulatory risk in the absence of express contractual provisions are conflicting. According to one set of principles, regulatory risk falls entirely on the purchaser. The seller's basic obligation is to convey a legally marketable title. The quality of a seller's legal title is unaffected whether the property is zoned for six units per acre or one. The buyer is responsible for knowing the laws in effect on the date the parties enter into the contract. "The general rule is that 'where a person agrees to purchase real estate, which, at the time, is restricted by laws or ordinances, he will be deemed to have entered into the contract subject to the same. He cannot thereafter be heard to object to taking title because of such restrictions.'"² Under this analysis the purchaser in the above example cannot rescind, assuming the wetlands law and local rules for assessing impact fees were in place when the parties entered the contract.³ Courts applying these principles point out that, if a changed condition enhanced the value of the property, the buyer would pocket the windfall. Therefore, as this logic dictates, the buyer should accept the bad with the good.

Despite this reasoning, courts often use the doctrines of mistake⁴ or

² *Pamerqua Realty Corp. v. Dollar Serv. Corp.*, 461 N.Y.S.2d 393, 395 (N.Y. App. Div. 1983) (quoting *Lincoln Trust Co. v. Williams Bldg. Corp.*, 128 N.E. 209, 210 (N.Y. 1920)). The sale involved two contiguous, improved lots, both to be conveyed to, and financed separately by, the buyer. The contract stated that the property was to be sold subject to "[z]oning regulations and ordinances of the city, town or village in which the premises lie which are not violated by existing structures." *Id.* at 394. The court interpreted this language as a warranty that each improved lot would comply with zoning after the lots were separately conveyed. However, if conveyed separately, the lots would have violated parking standards. In holding that buyer was entitled to rescission, the court held that the general rule in *Lincoln Trust* that a purchaser cannot rescind based on laws in effect on the date of purchase, does not apply when the seller warrants that the property will not be in violation of regulations and ordinances. *Id.* at 395.

³ The buyer may, however, have a good claim for compensation based on a theory of inverse condemnation. *See, e.g., Annicelli v. Town of South Kingstown*, 463 A.2d 133 (R.I. 1983) (holding that classifying purchaser's lot into a high-flood, danger zone and denying purchaser a building permit for a single-family house was a confiscatory taking that required compensation).

⁴ A mutual mistake about a material fact renders a contract voidable if the mistake was made at the time of contracting, has a material effect on the agreed exchange of performances, and the contract does not expressly or impliedly allocate the risk of a particular mistake to one of the parties. *See* RESTATEMENT (SECOND) OF CONTRACTS § 152

misrepresentation⁵ to grant buyers rescission before closing, and sometimes even after, when buyers lament that stealth land use controls obliterated their development aspirations.

Returning to the example, the court may grant the purchaser rescission if neither seller nor purchaser thought the riverfront site could ever be classified as wetlands because it appeared to be dry land. This would be a mutual and material mistake of fact affecting "the parties' understanding of the value of their bargain."⁶ If the sellers knew that either the wetlands classification or the fee increase were pending or imminent, their failure to disclose could be an innocent, negligent, or fraudulent misrepresentation, depending on what the buyers asked and on what the sellers or their agents actually told the buyers. This is a difficult type of mistake or misrepresentation case, with outcomes defying easy predictability.⁷

One commentator has summed up the mistake and misrepresentation case law by stating that courts apply the doctrines of mutual mistake and misrepresentation without "any degree of certainty."⁸ Courts blur the

(1981).

⁵ A contract is voidable when one of the parties enters the contract justifiably relying on a material misstatement made by the other. See RESTATEMENT (SECOND) OF CONTRACTS § 164 (1981).

⁶ *DiBiase v. Universal Design & Builders, Inc.*, 473 A.2d 875, 879 (Me. 1984).

⁷ In my reading of the cases, the purchaser in the above example would have a hard time prevailing in Oregon, but would likely prevail in Ohio and Delaware. Compare *Louis Scherzer Partners v. FDIC*, 885 F. Supp. 1415 (D. Or. 1995) (denying purchaser rescission after holding that agreement giving purchaser 90 days to investigate and approve purchase "shifted risks involving zoning and condition of property after closing to purchaser"), *aff'd*, 101 F.3d 705 (9th Cir. 1996), with *Reilley v. Richards*, 632 N.E.2d 507 (Ohio 1994) (granting purchaser rescission after finding that "[r]escission of real estate contract is proper when there is a mutual mistake as to character of real estate that was material to contract, and when complaining party has not been negligent in failing to discover mistake"), and *Shore Builders, Inc. v. Dogwood, Inc.*, 616 F. Supp. 1004 (D. Del. 1985) (finding that boilerplate clause in land sale contract, "which relieved sellers from any contractual liability in the event of misrepresentations," would not be effective because it would be inequitable, and stating that rescission is correct when there is a "mutual mistake as to a basic assumption" of the contract).

⁸ Frona M. Powell, *Mistake of Fact in the Sale of Real Property*, 40 DRAKE L. REV. 91, 118 (1991) [hereinafter Powell, *Mistake of Fact*]. See also Frona M. Powell, *Relief for Innocent Misrepresentation: A Retreat from the Traditional Doctrine of Caveat Emptor*, 19 REAL EST. L. J. 130 (1990) (demonstrating the varying application of the doctrines of mutual mistake and misrepresentation).

already fuzzy line between mistakes of law, which are never supposed to justify rescission, and mistakes of fact, which sometimes may. Courts disregard the "time honored distinction between mutual mistake and unilateral mistake of fact" and decide cases based on "contemporary standards of fairness," granting or denying relief based "on the particular circumstances of each case."⁹

A frequent theme in mistake cases is that the buyer purchased the property for a specific purpose, the seller knew of that purpose, one or both parties assumed the property could be used or developed as the buyer intended, and that assumption proved wrong.¹⁰ In successful rescission cases, the contract often describes the purchaser's intended use.¹¹ The purchaser, with a specific purpose in mind, may well have paid a premium for the land, anticipating benefits from a special use greater than normal

⁹ Powell, *Mistake of Fact*, *supra* note 8, at 118.

¹⁰ See, e.g., *Renner v. Kehl*, 722 P.2d 262 (Ariz. 1986). Purchasers acquired agricultural development leases covering 2,262 acres of unimproved desert land they believed suitable for jojoba production. After spending \$229,000 developing the land, the buyers determined the aquifer underlying the property was inadequate for commercial jojoba production. The court granted rescission, restitution for monies paid under the purchase-and-sale agreement, and reimbursement for costs they incurred in their attempt to develop the property to the extent their expenditures enhanced the value of the land.

¹¹ The contract in *DiBiase v. Universal Design & Builders, Inc.*, 473 A.2d 875 (Me. 1984), stated that "'Sunrise Terrace' [was] 'being sold as approved by Town of Cape Elizabeth for 23 single-family residential house lots . . . approved for subdivision as per the attached plan,'" subject to financing by Sun Savings and Loan Association. The buyer learned that the town intended to add new, costly conditions to the map approval, substantially increasing the funds the buyer would have to escrow with the town. Sun Savings refused to fund this additional sum and the buyer was granted rescission.

In *Garrison v. Berryman*, 594 P.2d 159 (Kan. 1979), the buyers purchased a lot for the construction of a single-family home. The court granted the buyers rescission because over one-half the lot was in a floodway where no home could be built. The court concluded the buyers would not be able to use the lot as intended.

In *Bar-Del, Inc. v. Oz, Inc.*, 850 S.W.2d 855 (Ky. Ct. App. 1993), the buyer contracted to buy a tavern with all the necessary accompanying licenses. The court granted the buyers rescission on discovering that zoning prohibited the tavern.

In *Gardner Homes, Inc. v. Gaither*, 228 S.E.2d 525 (N.C. Ct. App. 1976), the purchaser contracted to buy a 7-unit hotel for conversion into a 42-unit apartment house. The buyer's purpose was stated in the contract. The buyer later learned that the hotel was a nonconforming use and under the applicable zoning code, could not be expanded to accommodate the buyer's proposal. The buyer was granted rescission.

buyers would reasonably expect.¹² In effect, courts use the doctrine of mistake as a substitute for an implied warranty of fitness for a particular use.

Were the applicable default rule clear—say the homebuilder could rescind in the above example—only the sellers would have to worry about contracting out of the rule. The buyer would get the benefit of the doubt absent a contrary contract provision. But, when the default rule is unpredictable, as it is with regulatory risk, both parties have a stake in contracting out of the rule.

II. CONTRACT ANTIDOTES TO MISREPRESENTATION: DISCLOSURE, REPRESENTATIONS, AND INQUIRIES

Misrepresentation disputes are avoided by straight-forward tell-and-ask strategies.

A. Sellers Tell

A seller's natural instinct to accentuate the positive and eliminate the negative puts the seller at risk of a subsequent misrepresentation claim. However, sellers can prevent misrepresentation claims by divulging to the purchaser all information that could affect the sale.

Some states have promulgated mandatory disclosure forms for sales of residences, requiring the seller to describe the physical condition of the home and the neighborhood. However, there are no such mandatory disclosure forms for commercial buyers and sellers of development land. These parties must draft their own disclosure forms.¹³

¹² Economists call this "consumer surplus," "the difference between the maximum amount a person is willing to pay for a good and its current market price." KARL E. CASE & RAY C. FAIR, *PRINCIPLES OF ECONOMICS* 155 (3d ed. 1994). It is not possible to determine from court opinions in mistake cases whether buyers have paid a surplus. But if the buyers had proof, it would advance their claims for rescission.

¹³ Sellers of development land relying on boilerplate disclaimers in form residential contracts are inviting courts to disregard the entire contract because form disclaimers are "not the subject of genuine bargaining" and would lead to inequitable results. *Shore*

When drafting disclosure forms, sellers should keep several points in mind. First, to document their disclosures, sellers should include them in the written sales contract or accompanying exhibits and obtain signed receipts from buyers.¹⁴ In addition, sellers should reserve the right to modify and update their representations as new information becomes available, and to limit the buyer's remedy in the event of changes.¹⁵

Sellers should be aware that their disclosures do not contradict as-is clauses. Rather, disclosures complement them. An as-is clause is no defense to fraudulent misrepresentation or, in most states, concealment.¹⁶ "A seller cannot have it both ways: he cannot assure the buyer of the

Builders, Inc. v. Dogwood, Inc., 616 F. Supp. 1004, 1020 (D. Del. 1985).

¹⁴ The following illustrates disclosure at its best.

Seller's previous contract purchaser of the Property, Foster City Development, cut down all trees remaining on the Property during Foster City Development's due diligence period. Seller consented to the removal of the trees based on representations obtained by Foster City Development from Santa Clara County planners and County Counsel that the trees were not considered by Santa Clara County to be historic, and by Seller's own understanding that previous designation of the Property as historic had been limited to structures but not trees. However, following tree removal certain parties in Santa Clara County and the City of San Jose claimed that the trees also had been designated as historic. The City also objected to tree removal without City approval on non-historic grounds. This incident stimulated adverse publicity against the Property and Seller.

Agreement for Purchase and Sale of Real Estate by and between McTavish Corporation and Lincoln Property Company, p.10, sec. 2.5.2(f).

The prior owners of the Property operated various businesses on the Property, including a ranch, a rodeo, general agricultural activities, an orchard, a bar, and the storage of vending machines. The prior owners also at times allowed discarded appliances and other uncatalogued debris to accumulate and may have conducted other activities on the Property. Buyer acknowledges Seller's representation that the Seller may not be aware of aspects of such activities that raise the potential for environmental problems that have not been discovered by the Phase I Study and the Phase II Study. Buyer also acknowledges the Seller's representation that the prior owner continued to occupy the Property after Seller obtained title and during a dispute over ownership rights, and Seller did not control use of the Property during that time.

Id., p.11, sec. 2.5.2(j).

¹⁵ See *infra* Appendix at para. 10.

¹⁶ Compare *Prudential Ins. Co. v. Jefferson Assoc.*, 896 S.W.2d 156 (Tex. 1995) (stating in dicta that an as-is clause is no defense to seller's fraudulent concealment), with *Dennison v. Koba*, 621 N.E.2d 734 (Ohio Ct. App. 1993) (holding that an as-is clause bars claim for fraudulent nondisclosure, but not for fraudulent misrepresentation).

condition of a thing to obtain the buyer's agreement to purchase 'as is,' and then disavow the assurance which procured the 'as is' agreement."¹⁷

Finally, organizations should specify that the representations contained in the contract and the actual knowledge on which the representations are based refer only to the actual knowledge and representations made by certain named individuals within the organization, those with the competence and responsibility to represent the corporation in the particular transaction at hand, and no other employees or agents of the organization.

B. Buyers Ask

Purchasers should ask sellers what they know about the regulatory environment and embody the sellers' answers in contract representations. Asking the right questions prevents the seller from ducking behind the subtle distinction between nondisclosure and misrepresentation. A lying seller cannot claim to be merely not disclosing.¹⁸ Some buyers prepare an exhaustive list of questions (representations) for the seller. A seller's reluctance to sign a particular representation may signal an answer to a buyer's unasked question.¹⁹ In addition, purchasers should request copies of all past reports bearing on the feasibility of developing the property.²⁰

III. MISTAKE-FREE CONTRACTS

A. How Sellers Shut the Mistake Window

A charge of mistake is a fall-back position buyers take after failing to properly condition their purchase agreements. Some sellers believe they are

¹⁷ *Prudential*, 896 S.W.2d at 162.

¹⁸ *See, e.g., Van Camp v. Bradford*, 623 N.E.2d 731 (Ohio C.P. 1993). Both buyer and seller were single mothers with teenage daughters. Buyer asked seller whether neighborhood was safe. Seller knew about recent rapes in the neighborhood and said nothing. Seller's failure to disclose was a misrepresentation. Because buyer didn't address her question to brokers in the room at the time of buyer's inquiry, buyer's suit against brokers was dismissed.

¹⁹ Letter from Barton P. Pachino, Senior Vice President and General Counsel for Kaufman and Broad Home Corp., to author (Aug. 5, 1997) (on file with author).

²⁰ *See infra* Appendix at para. 11.

closing the mistake loophole by giving buyers the chance to inspect the property and to satisfy themselves about the feasibility of their development plans, including the right either to rescind the sale if they do not like what they discover during the due diligence period, or proceed with the sale as-is.²¹ Courts often disappoint sellers who rely exclusively on inspection and feasibility provisions to pin the regulatory risk on the buyer. Courts are prone to hold buyers responsible only for what they learn—or with reasonable effort should have learned—about the particular regulatory risk at issue.²² Sometimes, courts grant buyers relief when the regulations and ordinances change after the so-called due diligence date.²³ Some buyers reserve the right to rescind for late-breaking, bad news.²⁴

It is best for sellers to insist that the buyer's feasibility efforts match the buyer's anticipated use, and target potential problem areas for special study. "For example, the seller of hillside property subject to past remediation will want the buyer to have the benefit of a thorough geotechnical and hazardous materials study."²⁵

Sellers should give buyers the option to rescind based on adverse information obtained during the feasibility period. Sellers should insist that buyers electing to proceed anyway expressly assume all revealed risks,

²¹ See *infra* Appendix at para. 12.

²² Compare *Maloney v. Sargisson*, 465 N.E.2d 296 (Mass. App. Ct. 1983) (stating that where a party assumes responsibility to perform a test, it is responsible for mistakes therefrom; the court held that rescission on ground of mutual mistake was not proper where buyer agreed to perform soils test to determine if lot would "qualify for a building permit," performed test, and after closing, discovered tests were faulty, leaving lot unbuildable), with *Reilley v. Richards*, 632 N.E.2d 507, 509 (Ohio 1994) (granting buyer rescission after closing based on mutual mistake after holding that escape clause in real estate contract allowing buyer "sixty days from acceptance of this contract to satisfy himself that all soil, engineering, utility and other site related considerations are acceptable" did not place duty on buyer to discover that majority of lot was in a flood plane, precluding any construction).

²³ See *Shore Builders, Inc. v. Dogwood, Inc.*, 616 F. Supp. 1004 (D. Del. 1985) (recognizing under Delaware law that an action for rescission may exist for buyers when 38 of 238 lots appeared undevelopable due to wetlands restrictions, even though purchasers contracted to be responsible for securing all necessary building permits before closing).

²⁴ See, e.g., *Dover Pool & Racquet Club v. Brooking*, 322 N.E.2d 168 (Mass. 1975) (holding buyer contracting to purchase land for a pool and racquet club entitled to rescission when town amended applicable law two weeks after the contract was signed).

²⁵ Letter from Barton P. Pachino, *supra* note 19.

along with the risk of changes in the regulatory environment.²⁶

B. Contract Conditions Protecting Special Purpose Buyers

Buyers may save themselves the costs and uncertainties of challenging a transaction based on the doctrine of mistake by conditioning their obligation to purchase upon the property's suitability for their intended purposes. Typically, commercial developers specialize in particular market niches and have no interest in buying land they cannot use for their accustomed product. For instance, homebuilders specializing in the entry-level market work on thin profit margins and have no use for land that can only be developed at low densities with luxury infrastructure and large impact fees. To avoid becoming obligated to purchase land they cannot develop, these homebuilders, like many purchasers, condition the sale on their procuring specified government approvals within a prescribed time.²⁷

The seller considering an approval contingency should evaluate the buyer's competence and the likelihood that the buyer will obtain the requisite approvals within the scheduled time.²⁸ An approval contingency could encumber the property for one year or longer. If market values rise during that time, a buyer who cannot obtain approvals may decide to waive the approval contingency, close escrow, and resell the property at a profit. In declining markets such clauses give the buyer an incentive to disrupt the approval process in an effort to avoid the sale.

²⁶ "A Party bears the risk of a mistake when . . . he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient." RESTATEMENT (SECOND) OF CONTRACTS § 154 (1981).

The purchaser in *Louis Scherzer Partners v. FDIC*, 885 F. Supp 1415 (D. Or. 1995), *aff'd*, 101 F.3d 705 (9th Cir. 1996), was denied rescission when, several years after the closing, the county and state adopted wetlands ordinances and regulations substantially limiting the intended use of the property. In denying rescission, the court cited the purchaser's inspection opportunity and explicit assumption of risk in the contract. The contract language appears *infra* Appendix at para. 14.

²⁷ See *infra* Appendix at para. 15.

²⁸ "A seller can intelligently assess a buyer's ability to obtain the required approvals only if it fully understands the project . . . being proposed." Glenn D. Blumenfeld, *Dealing With Approval Contingencies in Agreements of Sale*, 27 REAL EST. REV. 25, 26 (1997).

The following are key issues in drafting approval contingencies.

1. *Specificity of Buyer's Program*

A carefully drafted government approval contingency clause starts with a detailed concept plan indicating precisely what the buyer seeks to build, over what time period, a list of all necessary approvals, and the estimated cost inclusive of infrastructure and fees.²⁹

Both buyer and seller benefit from identifying the buyer's specific plan for development. The seller may use the buyer's plan as an objective tool to measure the adequacy of the buyer's efforts to fulfill the approval contingency. If, eventually, the buyer backs out, the seller has had a chance to assure itself that the buyer is not committing the property to a use or costly conditions that will impede the future marketability of the site.

The buyer should describe precisely the requisite approvals to prevent the seller from forcing the buyer to close when a less than satisfactory approval is granted, one that is inconsistent with the buyer's intended project. Consider the apartment developer whose project required placement of twenty-five units per acre. He might have conditioned his obligation to purchase on a simple change of zone to R-4; at the time the contract was entered, local R-4 zoning allowed twenty-five units per acre. After closing, the city amended its R-4 zoning ordinance, reducing the allowable density to fifteen units per acre.³⁰ Luckily, the buyer had conditioned closing on the premises' being zoned R-4 "which will permit construction of multi-unit residential buildings . . . for sale as condominium units up to twenty-five (25) units per gross acre."³¹

A buyer reluctant to commit to a precise development plan before the contract is signed might contract to provide such details a few months later, stipulating that a failure to timely produce would justify the seller's

²⁹ See *id.* at 26.

³⁰ See *Evenline Constr. Corp. v. Miller's Plantation Dev. Co.*, 349 So. 2d 686 (Fla. Dist. Ct. App. 1977).

³¹ *Id.* The buyer was also wise to include the condominium language in its condition since some cities have amended their multi-family zoning to preclude condominium development or condominium conversions.

cancellation of the deal. Of course, the buyer should reserve the right to make reasonable changes in the project concept and the approval timetable as market and political fluctuations dictate.³² Still, the more precise the concept plan and comprehensive the list of requisite approvals, the easier it will be for the seller to monitor the buyer's progress.

2. *Timing of Approvals*

It is in the seller's interest to attach timetables indicating when the buyer's applications for various permits are to be filed, and when the buyer expects them to be acted upon. The buyer should be obliged to keep the seller informed of the buyer's progress. If significant deadlines are not met, even if the buyer is not at fault, the seller should have the option of terminating the sale.³³

If a buyer consents to an approval contingency containing a timetable that is too short, the buyer will have to choose between forfeiting the land after spending a significant amount of money to secure entitlements, or waiving the approval contingency and closing on property that may not be feasibly developed. At that point, buyers, hopeful but not certain of achieving acceptable final approvals, often seek time extensions from sellers who rarely hand such extensions out for free.³⁴ In such circumstances, it would be to the buyer's advantage to block the termination. The buyer might have reserved an option either to purchase the property immediately at the originally agreed price or keep the contract in place with a previously agreed markup of the nonrefundable fee or an already negotiated increase in the purchase price.

Even a buyer who obtains timely approval may face the dilemma of rescinding or taking the property as-is. Such a situation exists when a buyer is successful in obtaining full regulatory approval, only to have a neighborhood or environmental group subsequently challenge the approval

³² See Blumenfeld, *supra* note 28, at 26.

³³ See *infra* Appendix at para. 16.

³⁴ See, e.g., *Radley v. Johnson*, 519 N.E.2d 788 (Mass. App. Ct. 1988) (noting that seller's extension of buyer's time for performance in exchange for buyer's payment of property taxes and \$2,000/month reflected the parties' contemplation of considerable delay before closing).

in court. In these instances, the buyer will want the contingency period to be tolled pending the trial and all appeals.³⁵ The seller may refuse, arguing that the buyer should bear the risk of litigation delay because the buyer is a better judge of whether the lawsuit has merit.³⁶ A compromise would be for the seller to extend the contingency period with the understanding that the seller could market the property to others during the lawsuit. For example, such a compromise could state that if the seller finds a new buyer, the original buyer has seventy-two hours to waive its approval contingency and buy, or release the seller from the contract.

3. Setting an Acceptable Level of Impact Fees

Government approvals almost always come with costly conditions. A properly drafted approval contingency should specify the maximum acceptable level of such costs; an amount above which the parties agree is tantamount to no regulatory approval at all. A buyer would be entitled to rescind the contract if expenses exceed the prescribed amount. The seller could reserve the option of saving the deal by agreeing to reduce the purchase price by the amount of excess compliance costs. If the parties fail to specify a ceiling for condition expenses, the parties may be forced to allow a court to decide what level of cost is reasonable.

4. Setting the Seller's Price for the Approval Contingency

Buyer-friendly contracts should, and often do, limit sellers' remedies to a liquidated damage sum—generally, the down payment.³⁷ But a buyer who rescinds because of a failed contingency will not be liable for any damages, because the buyer has not breached the contract. Consequently, sellers usually insist that the buyer deliver a nonrefundable fee after a brief due diligence period—generally thirty or sixty days. Customarily, the seller credits this fee to the purchase price at closing.

In a recent article, an author admonishes sellers to set nonrefundable fees equal to the seller's opportunity costs of keeping property off the

³⁵ See Blumenfield, *supra* note 28, at 31.

³⁶ See *id.*

³⁷ See *id.* at 28; see also *infra* Appendix at para. 17.

market during approval contingency periods.³⁸ The author further advises that if the buyer will not agree to a substantial nonrefundable sum payable when the contract is executed, the contract should provide for escalating periodic payments as approvals are obtained.³⁹ The longer the property is kept off the market, the more the seller should retain if the buyer ultimately fails to close.

In contingent contracts, sellers often attempt to balance the risk of undercompensation, should the sale never close, with a hefty purchase price. Thus, a developer who completes the sale of property through a contingent contract pays a premium for the contingency. According to one builder, "We buy what we know can be developed. A contract contingent on zoning generally drives the price of land up."⁴⁰

5. *Safeguarding Buyers Against Third Party Claims*

Buyers working diligently to procure entitlements do not want to risk losing the property during the contingency period because either the seller transferred the property to a bona fide purchaser or the seller's mortgagees or intervening judgment creditors foreclosed liens against the property. The buyer needs the seller's cooperation in negotiating with prior mortgagees and creditors for notice and the right to cure defaults. In the purchase-and-sale agreement, the buyer should obtain the seller's promise not to further encumber the property and should reserve the right to allocate payments due under the contract to settle liens impairing the marketability of the seller's title.⁴¹ Buyers may protect themselves against subsequent purchasers or mortgagees by recording the parties' purchase-and-sale agreement.⁴² However, sellers may resist recordation because, if the deal fails, the recorded memorandum clouds the seller's title until the buyer signs and records a release.

³⁸ See Blumenfeld, *supra* note 28, at 28-29.

³⁹ See *id.*

⁴⁰ Roy L. Diez & William H. Lurz, *Advice From the Giants on Land & Politics: Answers to Questions About Land Acquisition and the Politics of Project Approval*, PROF. BUILDER, July 1988, at 88, 92.

⁴¹ See Blumenfeld, *supra* note 28, at 30.

⁴² See *id.*

C. Fitting Contract Conditions to Vested Rights

When homebuilders contract to buy finished lots,⁴³ they are depending on the sellers having tentative approval of a subdivision map. Sometimes homebuilders cautiously stipulate that the map must comply with all applicable local laws currently in effect, realizing that maps approved contrary to law are worthless unless the issuing locality can be estopped from revoking the map when the previously overlooked illegalities become apparent. Further, some buyers insist that no closing occur until after the period for challenging the subdivision map has run.⁴⁴

Even so, the homebuilder contracting to buy, contingent on map approval, is assuming more than the risk of having to comply with laws in effect at closing. The homebuilder is also vulnerable to new or changed laws enacted after the closing. In most states, only after the builder has constructed substantial improvements does the builder acquire "a vested right to complete construction in accordance with the terms of the permit" free of rules not in effect when the permit was issued.⁴⁵

Several state statutes require local authorities to evaluate subdivision applications based on rules in effect when developers submit their applications. However, these statutes are riddled with exceptions. To the extent of these various exceptions, homebuilders are still assuming

⁴³ A finished lot is commonly known as one ready for construction with all entitlements except a building permit, *i.e.*, a lot with all utilities in place at the site boundary ready for hook up.

⁴⁴ This time period concludes when "all administrative appeal periods for such approval have expired without filing of an appeal, or if an appeal is filed then on the date the appeal is resolved on terms satisfactory to Buyer." Kaufman and Broad Agreement for Purchase and Sale of Real Property, p.8, para. III(D). The appeal period for subdivision approvals is 90 days in California. CAL. GOV'T CODE § 66499.37 (Deering 1996).

⁴⁵ See *AVCO Community Developers, Inc. v. South Coast Reg'l Comm'n*, 553 P.2d 546, 550 (Cal. 1976). See generally *Dobbins v. Los Angeles*, 195 U.S. 223, 238-39 (1904) (After plaintiff had almost completed foundation for gas works facility, city amended ordinance to exclude gas works from the zone. Supreme Court ruled that property owner, "having partially erected the works, had acquired property rights . . . entitled to protection against unconstitutional encroachments."); Mark S. Dennison, Jr., *Zoning: Proof of Vested Right to Complete Development Project*, 35 Am. Jur. Proof of Facts 3d 385 (1996) (discussing majority view on development rights vested upon substantial reliance on validly issued permits).

retroactivity risk.⁴⁶ In California, an approved or conditionally approved tentative map holder is supposedly entitled to rely on the ordinances, policies, and standards in effect on the date the subdivider's application is deemed complete.⁴⁷ But there is a health or safety exception,⁴⁸ which local governments abuse by imposing conditions only marginally related to health or safety.⁴⁹

California homebuilders expected to find some shelter from retroactivity in an accompanying California statute. Under this law, cities and counties are absolutely barred from imposing new conditions when builders apply for building permits if those conditions could have been imposed earlier on the tentative tract map.⁵⁰ Unfortunately, judicial interpretation of this statute has disappointed buyers. An appellate court held that the statute did not prevent a city from imposing a public facilities impact fee on a developer at the building permit stage because the city had not enacted the fee ordinance until six weeks after the city approved the developer's subdivision map. This is one way to look at the phrase "could lawfully impose." Homebuilders hoped the court would interpret the statute as prohibiting the city from

⁴⁶ That is what happened to the buyers in *Regis v. Connecticut Real Estate Investors Balanced Fund, Inc.*, 613 A.2d 321 (Conn. App. Ct. 1992). The buyers, relying on a 6-year-old zoning permit the seller had obtained to build a 48-unit apartment on the site, bought the property. The property had only a 20-foot access to a public road. Later, the town changed its laws to require a 50-foot access. The town planning commission chairman wrote a letter assuring the seller the earlier zoning permit was still good even though the site lacked the newly imposed access refinement. However, when the buyers applied for a new permit 3 years later, the town applied the 50-foot rule and denied their application. The letter from the planning commission was worthless because the commission had no authority to grant variances from the access standard. The court also denied the petition for rescission since the sellers had never warranted or represented that the buyers could obtain a permit.

⁴⁷ See CAL. GOV'T CODE § 66498.1(b) (Deering 1996).

⁴⁸ "Notwithstanding subdivision (b), the local agency may condition or deny a permit, approval, extension, or entitlement if it determines any of the following: . . . A failure to do so would place the residents of the subdivision or the immediate community, or both, in a condition dangerous to their health or safety, or both." CAL. GOV'T CODE § 66498.1(c)(1) (Deering 1996).

⁴⁹ The California Court of Appeals interpreted this standard to justify retroactive application of a 650-foot setback to a crematorium based on the possibility of odors that "may occasionally occur" due to equipment malfunctions, fine ash fall out "not visually noticeable," and "small amounts of toxic emissions" if the facility burned plastics. *Davidson v. County of San Diego*, 56 Cal. Rptr. 2d 617, 619 (Cal. Ct. App. 1996).

⁵⁰ See CAL. GOV'T CODE § 65961 (Deering 1996).

applying the ordinance at the building permit stage because nothing had prevented the city from imposing the fees at the earlier subdivision approval stage, except the city's own delay in enacting the appropriate enabling regulation.⁵¹

Some homebuilders simply avoid situations in which the risk of retroactive zone changes or fee increases is imminent. Politically astute consultants warn their clients when local governments cannot be trusted. On the other end of the spectrum, homebuilders and buyers do not want to use valuable leverage trying to negotiate protection against such risks in jurisdictions when the retroactivity risk is minuscule.

Among the most effective arrangements for allocating the retroactivity risk to the seller is a promise to repurchase any lot on which the buyer "cannot secure all required permits for construction of the [buyer's] product"⁵² or any lot on which impact fees are levied after approval of the tentative tract map. Buyers who are uncertain of the seller's financial ability to repurchase may insist on a bond, letter of credit, or an escrow of all or part of the purchase price, to be released only when the buyers' rights vest under local law. Most sellers will think the buyer mad for suggesting that the seller repurchase lots after closing, but at least one national homebuilding firm places this type of clause in all contracts to purchase finished lots.⁵³

Another method used by developers to hedge against the risk of retroactive application of new or changed laws is the so-called development agreement. This type of agreement is authorized by statute in ten states and by implication in many more. Under a development agreement, developers bargain with state and local agencies to assure that their projects will be

⁵¹ See *Golden State Homebuilding Assoc. v. City of Modesto*, 31 Cal. Rptr. 2d 572 (Cal. Ct. App. 1994). Even the court recognized the anomalous result of its interpretation: "a local agency which is slow to adopt development regulations retains more freedom to impose them than one which adopts the same regulations early in the development process." *Id.* at 577. The court placed the anomaly at the legislature's doorstep, not its own.

⁵² See *infra* Appendix at para. 18; see also *Knight v. McCain*, 531 So. 2d 590 (Miss. 1988) (noting seller promised to refund all buyers' money if they could not obtain a permit to build a house on the lot).

⁵³ Interview by author with Frank Scardina, President, The Ryland Group, Inc. West Region, May 28, 1997.

subject only to the laws in effect when the agreement is concluded. Development agreements are especially important in multi-phase projects scheduled over many years. Thus, developers, having made significant infrastructure investments early to service the long-range needs of the entire project, may avoid the risks of lowered allowable densities or increased impact fees. Typically, these agreements are costly and time consuming to negotiate. Furthermore, local governments are generally not interested in entering into such arrangements except in exchange for substantial concessions that they could not otherwise have lawfully obtained from the developer. Nevertheless, some developers view development agreements as insurance policies well worth the premiums.

Having persuaded the local government to enter a development agreement, the developer should insist that the agreement be assignable and run with the land for the benefit of any lenders, lessees, or subsequent purchasers.⁵⁴ The developer is then positioned to confer on the buyer some immunity from regulatory surprise.

Neither vested rights statutes nor development agreements protect purchasers from complying with state and federal laws.⁵⁵ Informed buyers condition their obligations on the presumption that no government authority will apply rules that would prevent desirable development of the property.⁵⁶

⁵⁴ Local governments insisting on the right to approve assignees are limiting the effective alienability of the property. Even a lender approved by the city should not accept a provision that the lender, upon foreclosure, may not assign without the city's consent. First, in the event of default, the original developer and lender may want to arrange a sale to a third party. The requirement of prior city approval complicates what would usually be a delicate workout process. Second, if there is a foreclosure, well-informed buyers will not be satisfied knowing they cannot buy without city approval. Sellers will view city approval of their potential buyer or lender as impairing their exit strategy.

⁵⁵ See *Florida Game & Fresh Water Fish Comm'n v. Flotilla, Inc.*, 636 So. 2d 761 (Fla. Dist. Ct. App. 1994). In this case, the government halted a Florida developer's project when "a bald eagle's nest was discovered in a tree situated within the project's fourth phase." The court denied the developer's claim for compensation based on a regulatory taking. Rather, the government was only protecting wildlife, and the court viewed the bald eagles, not the government, as responsible for the nesting location.

⁵⁶ Authority is best defined as: all federal, state and local governments and quasi-governmental agencies, bodies, entities, boards, and authorities that have jurisdiction over the property, the furnishing of utilities or other services to the property, or the subdivision, improvement, development, occupancy, sale, or use of the property, including without limitation, the Federal Housing Administration and the Veterans

D. Why Not Options?

Why do builders use contracts instead of options? Options are easier to draft. Contingencies in option contracts do not have to be specified as meticulously as in a contingent contract, since the buyer is free to walk away simply by declining to exercise the option. Options are also air tight; they leave no room for sellers to challenge the buyers feasibility decision by persuading a court to second guess whether the contingencies were, or with reasonable effort, could have been met.

In fact, most builders and developers prefer options, but many sellers shun them. Sellers want a sale, not a protracted waiting period. Generally, sellers grant options only for troubled sites, or in exchange for substantial option fees and inflated purchase prices.

Many savvy buyers use purchase-and-sale agreements that are indistinguishable from options—contracts that allow buyers to exit anytime during the feasibility period for an agreed, nonrefundable fee. Sellers generally sign these option-like contracts assuming that the buyer would not go to the trouble of detailing extensive contract provisions unless the buyer was committed to purchase the property.

E. Seller Financing

Sellers often agree to become project financiers, deferring payment of the purchase price in exchange for a much higher sales price than they could otherwise command in a typical all-cash closing. There almost always is a large disparity between the all-cash price and the seller-financed price of development land. Capital sources for land acquisition are scarce and too risky for most traditional real estate investors. Sellers and investors willing to assume the risks do so with the promise of especially generous compensation.

Buyers and sellers of development land are often driven to use vendor financing because they cannot agree on a fixed price for the land. They

Administration. See Ryland Group Agreement of Purchase and Sale (Finished Lots) para. 1(a) (June 28, 1995).

must usually rely on the land residual method, the most speculative of appraisal techniques.⁵⁷ To illustrate: *X* owns an undeveloped lot in an area mostly built with large residences. Just last year *Y*, a local builder/developer, purchased the parcel adjoining *X*'s property for \$100,000, hired a builder to construct a 6,000 square foot house on the lot at \$100 per square foot (or \$600,000), and sold the house immediately on completion for \$1,000,000—excluding brokerage commissions and closing costs. Based on *Y*'s experience last year, *X* determines that her lot is worth approximately \$400,000, calculated by subtracting from *Y*'s \$1,000,000 sales price the \$600,000 it would cost to build a comparable house on her lot.

The seller's land residual calculation is as follows:

Sales price of completed house: \$1,000,000
Construction cost: \$600,000
Land residual value: \$400,000

Y, on the other hand, is not sure *X*'s lot is worth \$400,000, as the luxury market has been overbuilt in the past year. *Y* doubts the house would sell for more than \$750,000 in this year's market. Also, the local government enacted new impact fees totaling \$10 per square foot, which will be collected with the building permit fee. These fees add \$60,000 to *Y*'s cost of development. *Y* looks for a 20% return on land investments, and estimates the project will take a year to complete. On this basis, *Y* can only offer *X* \$75,000 for the land.

The buyer's land residual calculation shows:

Sales price of completed house: \$750,000
Construction costs including new impact fees: \$660,000
Land residual value: \$75,000 (\$90,000 less a 20% return on the \$75,000 land purchase price)

⁵⁷ This method for valuing vacant land begins with the appraiser's visualizing and specifying the improvement that might be built on the land that would result in the highest present value of the land. See JAMES A. BOYKIN & ALFRED A. RING, *THE VALUATION OF REAL ESTATE* 360 (4th ed. 1993). This method is only used when the direct sales method cannot be used because of a lack of comparable properties in the marketplace. For simplicity, the example in the text avoids the nuances of capitalization.

The price gap between *X* and *Y* appears insurmountable unless *X* and *Y* can structure the land purchase price contingent on *Y*'s realized yield. *X* and *Y* could become partners, with *X* contributing the land to a limited liability company with *X* and *Y* as members. Or *X* could sell to *Y* with all or most of the purchase price deferred and secured by an installment land contract, purchase money mortgage, deed of trust, or long-term ground lease. Another alternative would be for *X* and *Y* to set the purchase price at a low fixed amount, such as \$50,000, plus a percentage of *Y*'s eventual net sales price or a share of *Y*'s gross sales price. *X* could subordinate her security interest to some or all of *Y*'s construction financing. The parties could structure their loan agreement such that *Y*'s repayment of *X*'s loan could be due early, paid in equal monthly or annual installments, or deferred until *Y* sells the house. These are only some of the permutations of vendor financing. The full list of financing possibilities is enormous and well beyond the scope of this Article. But this example indicates why and how sellers sometimes agree to finance the sale of development land.

Buyers prefer a pay-when-paid contingency in vendor financing transactions. Consider the following example. The buyer agrees to pay the seller \$10,000 for each approved lot, due and payable one year after the buyer receives an approved tentative tract map. By the terms of the agreement, the seller reserves the right to foreclose its purchase money deed of trust if the buyer fails to make the promised payment on schedule. Although the local government approves the buyer's map for two hundred units, the government surprises the buyer by subsequently enacting a legally enforceable growth-control ordinance limiting building permits for new houses to forty per year. Unfortunately, the buyer, in its contract with the seller, set the land purchase price under the presumption it could build houses and close sales on all two hundred lots on its approved map by the time its purchase money obligation to the seller matured. Under the new ordinance, timely payment would be impossible. It will take the buyer at least five years to build on and market all of the lots. Unless the buyer can refinance or otherwise satisfy the seller's loan, the buyer risks forfeiting the property through foreclosure.

IV. CONTRACTING FOR THE OBLIGATION TO SECURE ENTITLEMENTS AND PAY FOR IMPROVEMENTS

For land to be developed, someone must secure all requisite government approvals, primarily from local governments. New subdivisions require new capital improvements—sewer, water, electric, and cable hook-ups, and roads—all of which developers are expected to provide within their own sites. Increasingly, local governments require subdividers to contribute to the enhancement of public facilities outside the boundaries of their projects.

Sometimes when the transaction involves a short-term purchase-and-sale agreement without vendor financing, buyers and sellers do not specify who has the obligation to secure entitlements and fund or install improvements. However, if the sale involves vendor financing, the parties almost always expressly allocate these obligations.

An obligation to secure entitlements differs from an approval contingency. When an approval contingency fails, the contract is rescinded and the buyer's downpayment is refunded unless the contract calls for a non-refundable fee. When a buyer or seller breaches a promise to secure entitlements or make improvements, the other party may be in a position to claim substantial damages. The consequences of a breach and a failed contingency are the same only when a contracting party's sole remedy at law or equity is limited to liquidated damages in an amount equal to the nonrefundable fee.

A. When Sellers Are Obligated to Secure Entitlements

In their agreements, buyers of finished lots almost always include detailed lists of approvals that sellers must secure, development standards for seller improvements, and timetables. Such contracts generally state that the purpose of seller's obligations is to enable the "buyer [to] obtain any and all permits including, but not limited to, building permits . . . from any and all Authorities having jurisdiction over the construction, completion, use,

and occupancy of any Homes contemplated to be constructed on the Lots."⁵⁸ The seller's conveyance includes an assignment of "all permits, approvals, privileges and entitlements appurtenant."⁵⁹

In addition, buyers generally attempt to reserve all rights and remedies in the event of a breach by the seller, provide specific penalties for the seller's failure, and contract for the right to assume the seller's stalled or failed processing effort "if the seller is not making sufficient progress within a given period of time (with the buyer's costs of pursuing entitlements deducted from the purchase price)."⁶⁰ The timing of the seller's completion of entitlement processing often becomes a key issue of negotiation⁶¹ because many buyers realize that there may only be certain windows of opportunity during which projects will be successful. Timing is critical because market conditions change, new products become available from other builders, and regulation compliance costs may increase.⁶²

Courts, recognizing that they are continually ill-equipped to supervise the seller's judgment and skill, probably will not grant specific performance of a seller's promise to secure entitlements.⁶³ Courts grant specific performance only to buyers who are willing to waive the entitlement condition.⁶⁴ Courts, however, may award damages, unless the buyer has relinquished the right to damages by contract. Sellers cut their losses, if the costs of securing entitlements and making improvements become excessive, by restricting the buyer's choice of remedies for the seller's breach to termination of the agreement or the right to take the property as-is without entitlements or improvements.

⁵⁸ Ryland Group Agreement of Purchase and Sale (Finished Lots) p.J1-6, sec. 2(j), Ex. J1 (June 28, 1995) (on file with author).

⁵⁹ *Id.*

⁶⁰ Letter from Barton P. Pachino, *supra* note 19.

⁶¹ *Id.*

⁶² *Id.*

⁶³ As the remedy by specific performance requires the court to execute both sides of the transaction, the court, as a general rule, will not entertain jurisdiction of an executory contract in which the plaintiff's undertaking is to perform personal services, or a course of conduct involving acts of volition, judgment, skill, or direction extending over a considerable period of time.

J.E. Macy, Annotation, *Mutuality of Remedy as Essential to Granting of Specific Performance*, 22 A.L.R.2d 508, 539 (1952).

⁶⁴ See, e.g., *Turk v. D. Katz & Sons, Inc.*, 385 A.2d 583 (Pa. Super. Ct. 1978).

A seller's ambiguous assurance that it will obtain subdivision map approval or a zone change is usually interpreted as a condition that gives the buyer only the right to rescind if the seller fails, but does not give the buyer the right to damages or to specific performance with a price abatement equal to the cost of compliance.⁶⁵ Sellers must expressly obligate themselves to secure entitlements or pay for improvements on- and off-site; courts will not imply these obligations.

B. When Buyers Are Obligated to Secure Entitlements

Buyers conditioning their obligation to buy on a zone change or tract map approval have an implied obligation to use due and reasonable diligence in pursuing the regulatory approval⁶⁶ and must at least incur the costs of completing an application for a zoning change, attend hearings, and offer credible, prepared supporting witnesses.⁶⁷

Even when local officials initially oppose the buyer's proposal, buyers cannot invoke approval conditions to justify rescinding unless they have diligently pursued their entitlements. "The law does not require Purchaser to do a vain thing. However an unlikely thing is not synonymous with a vain thing. Initial opposition is sometimes overcome."⁶⁸

Once the buyer files the application and city officials indicate they are going to impose costly conditions not originally contemplated by the buyer, the buyer need not carry the proposal to the final submission stage. In one case, city officials were willing to place the property in a planned unit development zone, but indicated they would only approve the site plan if the developer solved a major off-site traffic problem. At that point, the buyers

⁶⁵ See, e.g., *Schreiber v. Karpow*, 626 P.2d 891 (Or. 1981) (holding that seller's promise to "take care of" zone and subdivision approvals did not imply a promise to build a road; buyer's remedy was rescission only, not specific performance).

⁶⁶ See, e.g., *Rhodes Dev. Co. v. Simpson*, 658 S.W.2d 218 (Tex. App. Ct. 1983) (denying buyer rescission when buyer justified his failure to apply for rezoning only on the advice of local counsel that buyer's plans were not likely to be approved by the local planning and zoning commission).

⁶⁷ See, e.g., *Leonard v. Koval*, 543 N.E.2d 911 (Ill. App. Ct. 1989) (holding that buyer did not meet obligation to use best effort to secure zone change as evidenced by failure to present credible expert testimony and failure to take an administrative appeal).

⁶⁸ *Riverfront Investors Group v. Chavez*, 644 So. 2d 247, 252 (La. Ct. App. 1994).

stopped pursuing their zoning approval and attempted to rescind the purchase-and-sale contract. The sellers claimed the buyers were withdrawing because of a general decline in the housing market. The court didn't think that mattered. "A party may be dissatisfied with a number of aspects of a bargain, some of which allow him to repudiate the contract and some of which do not. If one of the sources of dissatisfaction gives him a right under the contract to repudiate, the fact that there are other sources of dissatisfaction is immaterial."⁶⁹

Most sellers, especially financing vendors, do not want to rely on what courts might imply. Savvy sellers "hold the buyer to specific timing requirements to obtain certain entitlements . . . so that buyer cannot simply tie up the property indefinitely [causing the seller to miss the market]."⁷⁰ Sellers should be wary of buyers that obtain entitlements, if the buyer fails to close

limit[ing] seller's ability to market the property at a later date. Although changed market and political conditions may justify program revisions, the vendor will want the right to veto changes in the buyer's program or schedule. Most sophisticated sellers (or even unsophisticated sellers well represented by counsel) will insist upon the right of prior review and approval before buyer's entitlement requests are submitted to local government. In exercising their "review and approval" they cautiously avoid trying to tell the buyer how to run the show, for fear of being labeled "co-producers" or co-venturers, if the project fails. They will want substantial (and escalating) liquidated damages if the buyer fails to close after entitlements have been secured.⁷¹

Sellers may specify that the buyer's failure to meet the entitlement schedule will result in the seller's right to foreclose. In addition, the seller should include a clause in the sales contract that requires the buyer to make a deficiency payment if the value of the security property falls below a pre-arranged floor.

⁶⁹ *Columbia Christian College v. Commonwealth Properties*, 594 P.2d 401, 408 (Or. 1979).

⁷⁰ Letter from Barton P. Pachino, *supra* note 19.

⁷¹ *Id.*

C. Buyers Facing Condemnation and Confiscatory Regulation

Consider a buyer's situation when the government initiates condemnation proceedings while the property is under contract. For example, a homebuilder contracts to purchase ten acres at \$10,000 per acre for the development of a housing tract of fifty houses with five units per acre. The property is zoned to provide a buffer between higher density apartments on the south, east, and west (built many years ago at twenty-five units per acre), and an upscale community of large houses on half-acre lots abutting the development site to the north.

With approval of a tract map, the builder would be fully entitled to obtain building permits and start construction. At this point the property would be worth \$50,000 per acre, or \$500,000 total. The contract is conditioned on local government approval of a tentative tract map. The builder spends \$85,000 in engineering and environmental studies, preparation of a subdivision plan, and filing fees. Approval is in sight; there are no legitimate objections to map approval. Two weeks before the builder's tract map reaches the council agenda, the homeowners to the north persuade the city council to acquire the builder's ten acres as a park.

City officials attempt to negotiate a price with buyer and seller. The city offers \$100,000, then \$185,000. The buyer and seller hold out for \$500,000, anticipating a favorable standard jury instruction that fair market value includes reasonably probable land use approvals.⁷² The city files a condemnation action.

What are the buyer's choices, assuming the purchase-and-sale agreement has no condemnation provision? Must the purchaser waive the land use approval contingency and take title? Alternatively, may the purchaser wait to see how high the condemnation award is, invoking the contract's contingency provisions (which are not satisfied) to rescind if the award is lower than the contract price, waiving the contingency and pocketing the excess if the award is greater?

In many states, under the doctrine of equitable conversion, the risk of

⁷² See 7 JULIUS L. SACKMAN ET AL., NICHOLS ON EMINENT DOMAIN § 8.11(4), Instruction No. 17 (3d ed. rev. 1997).

loss, absent a contrary contract provision, would fall on the purchaser.⁷³ The seller would have a lien against condemnation proceeds for the unpaid balance of the purchase price,⁷⁴ and the purchaser would be entitled to the excess.⁷⁵ In other equitable conversion states, the vendee would be entitled to rescind and recover any purchase money paid before the condemnation.

The buyer under a contingent contract might be regarded as an optionee, instead of a purchaser, unless the buyer waived contingency rights. The contingent contract resembles an option in that the contingency buyer has considerable leeway to decide whether to buy, and the seller's sole remedy for buyer's breach will ordinarily be liquidated damages. The contingent contract differs from an option in that the contingency buyer has an implied good faith obligation to petition for entitlements. Once approvals are granted, the buyer is contractually obligated to complete the sale.

Assuming courts would treat the contingency buyer as an optionee, courts are divided on whether optionees are entitled to condemnation proceeds in excess of the purchase price. Some courts hold that optionees, until they exercise their options, have no right to condemnation proceeds because otherwise, optionees could gamble on the outcome in the condemnation award proceedings.⁷⁶ An optionee satisfied with the award could exercise the option at that point; the optionee not satisfied could walk away from the transaction. This lack of mutuality troubles some courts. Other courts regard options as substantial interests in land, even before exercise, recognizing that optionees will expend considerable time and expense in furthering their expectation of realizing value in excess of the optioned

⁷³ See V. Woerner, Annotation, *Rights and Liabilities of Parties to Executory Contract for Sale of Land Taken By Eminent Domain*, 27 A.L.R.3d 572 (1966).

⁷⁴ In addition to the purchase price, a seller who makes improvements required by contract so the buyer can subdivide the property is entitled to reimbursement from the condemnation award even though, because of the condemnation, the property was never subdivided. See *Berry v. Kettle*, 63 Cal. Rptr. 804 (Cal. Ct. App. 1967).

⁷⁵ See, e.g., *Arko Enterprises, Inc. v. Wood*, 185 So. 2d 734 (Fla. Dist. App. Ct. 1966) (noting that vendor, contractually obligated to secure entitlements and make improvements, had not yet done so when the property was condemned, and holding that vendor was entitled to lien against condemnation award for originally agreed purchase price purchaser was entitled to balance of condemnation award). See also 2 JULIUS L. SACKMAN ET AL., *NICHOLS ON EMINENT DOMAIN* § 5.02(3)(a) (3d ed. rev. 1997) (recognizing that purchaser, as equitable owner, should receive excess of condemnor's award over vendor's sale price).

⁷⁶ See *Cravero v. Florida State Turnpike Auth.*, 91 So. 2d 312 (Fla. 1956).

price. Consequently, these courts have no trouble awarding optionees condemnation awards in excess of the option price.⁷⁷ In states in which optionees have no right to condemnation awards, the builder entering a contingent contract should explicitly deal with the condemnation issue.

Under the Uniform Vendor and Purchaser Risk Act [hereinafter UVPRA], enacted in thirteen states,⁷⁸ when property is destroyed or taken by condemnation during the executory period, and neither title nor possession has passed to the buyer, the buyer has the choice of rescinding or taking the property as-is. State courts differ on whether the purchaser has the option of taking the property along with an assignment of the seller's insurance or condemnation proceeds.⁷⁹ In states denying buyers that choice, buyers may reserve the right to condemnation of insurance proceeds by contract, as the UVPRA applies only in the absence of a contrary agreement between the parties.⁸⁰

Buyers prefer condemnation clauses giving them the choice of rescinding and getting back their down payments, or performing the contract with an assignment of all sellers' rights to condemnation proceeds in excess of the unpaid balance of the contract price.⁸¹ If the buyer closes, pays the full contract price, and accepts a deed, the seller should assign condemnation proceeds to the buyer by separate agreement.⁸²

What would the buyer's situation be if the local government decided it could not afford to condemn the property and, instead, re-zoned it for open space, precluding any economically viable use of the property? Assume that the seller would be entitled to compensation for a regulatory taking.

⁷⁷ See *County of San Diego v. Miller*, 532 P.2d 139, 144 (Cal. 1975).

⁷⁸ The thirteen states that have adopted the UVPRA in full or in part are: California, Hawaii, Illinois, Iowa, Michigan, Nevada, New York, North Carolina, Oklahoma, Oregon, South Dakota, Texas, and Wisconsin. See UNIF. VENDOR AND PURCHASER ACT, 14 U.L.A. 469 (1990) (Table of Jurisdictions).

⁷⁹ California courts have denied this remedy; New York courts have granted it. Compare *Lucenti v. Cayuga Apts., Inc.*, 399 N.E.2d 918 (N.Y. 1979) (allowing purchaser specific performance with abatement), with *Dixon v. Salvation Army*, 191 Cal. Rptr. 111 (Cal. Ct. App. 1983) (denying specific performance with abatement).

⁸⁰ See UNIF. VENDOR AND PURCHASER ACT § 1, 14 U.L.A. 471 (1990).

⁸¹ See *infra* Appendix at para. 19.

⁸² See 2 JULIUS L. SACKMAN ET AL., NICHOLS ON EMINENT DOMAIN § 5.02(3)(c) (3d ed. rev. 1997).

Suppose the builder decides to go through with the sale, waiving the approval contingency, despite the change of zone, because counsel has confidently informed the builder that the open space zoning is confiscatory and the city would have to pay for the land just as if the city condemned the property outright. The builder believes that when the city is confronted with this possibility, the city will relent, return the property to its former zoning, compensate the builder for the temporary taking, and approve the tract map.

Once the builder closes, pays the contract price, and takes title, will the builder be entitled to raise the regulatory taking claim and obtain compensation? Courts and commentators are divided. Some believe a buyer who purchases with notice has the right to only the investment-backed expectations that existed when the buyer purchased the property. The builder acquired title with full knowledge of the open space zoning and could have rescinded by invoking the approval contingency. These authorities assume the buyer's purchase price reflected the value of the property as it was zoned so that compensating the buyer would be a windfall.⁸³ Other courts allow the buyer to challenge laws existing at purchase, reasoning that "[a]n otherwise unconstitutional ordinance . . . does not lose this character and immunize itself from attack simply by the transfer of property from one owner to another."⁸⁴ These courts protect the alienability of the seller's property right to challenge the offending law.⁸⁵

Buyers may be able to avoid the cross-fire among these conflicting views by contracting for the seller to assign the buyer all claims, counter-claims, defenses or actions, including claims against governments for regulations imposed prior to closing. The seller should also promise, at buyer's request and expense, to join the buyer in any such action.⁸⁶

⁸³ See *Anello v. Zoning Bd. of Appeals*, 678 N.E.2d 870 (N.Y. 1997). Petitioner unsuccessfully appealed denial of a variance to build a house on a lot subject to a steep-slope ordinance. The court held the purchaser never acquired a right to build on the property free from the steep-slope ordinance because the ordinance was in place when she acquired title. The purchaser's challenge was to the ordinance as applied, not a facial challenge.

⁸⁴ *Kropf v. City of Sterling Heights*, 215 N.W.2d 179, 184 (Mich. 1974).

⁸⁵ See WILLIAM A. FISCHER, REGULATORY TAKINGS 194 (1995).

⁸⁶ Even New York courts have implied that the buyer with an assignment of the seller's right to raise takings claims would be allowed to raise the claim. See *Anello v. Zoning Bd. of Appeals*, 678 N.E.2d at 870; see also *infra* Appendix at para. 20.

V. CONCLUSION

Buyers and sellers of development land need to take into account frequent and sometimes unpredictable changes in government regulations. When those regulations foreclose profitable development, courts are torn between two incompatible sets of norms, one shifting the risk to the purchaser, the other to the seller. Courts presume realty purchasers enter their contracts only after researching the laws in effect, and adjust their contracts accordingly. However, when buyers cannot use the property for intended purposes, courts sometimes excuse buyers from their contracts under the doctrines of mistake or misrepresentation.

Sellers position themselves to defeat misrepresentation claims by disclosing all they know that could matter to a buyer. No substitute exists for a full and complete disclosure. Sellers achieve nothing with boilerplate language stating that the buyer is not relying on seller representations, but only on the buyer's own inspection. As-is clauses are also futile if the seller withholds valuable information. The seller's representations should reveal all facts about the particular site that could affect a buyer's decision—whether or not the seller believes the buyer's concerns would be justified. Buyers may obtain useful information and block sellers from hiding in the cracks between nondisclosure and misrepresentation by asking sellers directly what they know about issues of potential concern and by insisting on extensive seller representations and warranties.

Sellers minimize claims of mistake by allowing a buyer time to study the feasibility of the site for development. The contract should place the full burden of the feasibility determination on the buyer. A buyer who is not satisfied following the feasibility period should have the option of rescinding. The buyer who then elects to proceed with the sale should expressly assume all regulatory risk, including the risk of regulatory change.

To ensure that they do not become obligated to purchase properties they cannot profitably develop, special purpose buyers need to do more than reserve a due diligence period after which they can decide not to purchase. These buyers must contract that unless they obtain specified government approvals within prescribed times, the deal is rescinded. Drafting approval contingencies sufficiently detailed for a seller to police for the buyer's "good faith" compliance is difficult.

Sellers are often induced to accept approval contingencies if the contract obligates the buyer to pay the seller an ample, nonrefundable fee if for any reason the seller decides not to buy after the feasibility inspection period. Sellers, especially those who provide vendor financing and who expect buyers to process entitlements, need to estimate how the buyer's entitlement efforts will impact the seller's security interest if the buyer defaults and the seller has to take back the property.

Many buyers condition contracts on either sellers' or buyers' obtaining an approved tentative tract map. Approval will not necessarily protect buyers against changes in local rules enacted after the map is approved, but before the buyer has substantially relied on a lawfully issued building permit. Cautious buyers deflect the risk of retroactively applied rules by insisting that the seller repurchase property when the buyer cannot obtain suitable building permits. Few sellers, however, will accept this burden.

If the buyer expects the seller to secure entitlements and pay for infrastructure improvements, the seller's obligation needs to be described with the same clarity as would a general contractor's promise to build a road or school. Courts interpret a seller's ambiguous assurance that the seller will obtain entitlements or make subdivision improvements as a condition only, and not as an obligation for which the breaching seller would be liable for damages. Sellers wishing to limit their exposure from such promises, should restrict the buyer's remedies for seller's breach to rescission or the right to buy as-is. Buyers, reluctant to see market opportunities drift away while the seller lags, should insist on timely performance, substantial damages for inadequate seller processing, and the right to take over processing, while deducting the costs from the purchase price.

In the event of a condemnation or confiscatory regulation arising during the executory period, the buyer under a contract with an unfulfilled approval contingency should reserve the option of rescinding or closing with an assignment of the seller's interest in the condemnation proceeds. Buyers facing potentially confiscatory regulations should require an assignment of the seller's rights to challenge the regulation, and the seller's promise to become a nominal party to the buyer's challenge.

APPENDIX

Examples of Contract Representations and Conditions Appropriate for Allocating Regulatory Risk

1. Seller Representations of No Known Regulatory Risks.

There is no litigation, or investigation or administrative proceeding by any Governmental Agencies which is pending and which has been served on Seller and, to the actual present personal knowledge of [named individuals], without any independent investigation or duty of inquiry, there is no threatened litigation, or threatened investigation or administrative proceeding by any Governmental Agencies, against Seller or the Project, which pending or threatened litigation, investigation or proceeding would materially impair or materially adversely affect Seller's ability to perform its obligations under this Agreement or the development of the Project in a commercially reasonable manner. Purchaser shall have the burden of establishing such actual present personal knowledge in the event of any alleged breach of this representation.⁸⁷

No Notices of Violations. As of the Contract Date only, Seller has not received from any Governmental Agencies any written notices of material violations of any statutes, laws, regulations or rules relating to the Project which notices are still outstanding or have not been cured.⁸⁸

Notice of Condemnation. As of the Contract Date only, Seller has not received any written notice from any competent condemning authority regarding the institution of any condemnation action seeking to condemn any interest in all or any portion of the Project.⁸⁹

Governmental Agreements. As of the Contract Date only, Seller has not received any written notice of any breach of any operative and binding written agreement or contract between Seller and the City,

⁸⁷ Agreement of Purchase and Sale by and between Redwood Shores Properties and SNS Equities, Inc. 20-21, § 8.1.4.

⁸⁸ *Id.* at 21, § 8.1.5.

⁸⁹ *Id.* at 22, § 8.1.9.

District or any other Governmental Agencies or public entity or government regulation that has not been cured and that would materially impair or materially adversely affect development of the Project in a commercially reasonable manner.⁹⁰

2. Seller's Representation Regarding Soils Conditions.

With the exception of those disclosures set forth in [this Agreement or in incorporated documents] . . . to the actual present personal knowledge of [named individuals] without any independent investigation or duty of inquiry, there are no latent soils conditions on, under or in the Project that would materially impair or materially adversely affect development of the Project in a commercially reasonable manner. Purchaser shall have the burden of establishing such actual present personal knowledge in the event of any alleged breach of this representation.⁹¹

3. Seller's Representation of No Toxic or Hazardous Material.

With the exception of the disclosures set forth in [this Agreement or incorporated documents] . . . as of the Contract Date only, (I) during Seller's ownership of the Project, Seller has not used, stored, released or discharged any Hazardous Materials (as defined in Schedule 1) on the Project in violation of the Environmental Laws (as defined in Schedule 1)[;] and (ii) to the actual present personal knowledge of [named individuals], without any independent investigation or duty of inquiry, (a) there are no Hazardous Materials on, under or within two thousand (2000) feet of the Project in violation of existing Environmental Laws and (b) there are no underground tanks, storage facilities or holding vaults on or under the Project. Purchaser shall have the burden of establishing such actual present personal knowledge in the event of any alleged breach of this representation.⁹²

⁹⁰ *Id.* at 22, § 8.1.12.

⁹¹ *Id.* at 21, § 8.1.7.

⁹² *Id.* at 21, § 8.1.6.

4. Seller's Representation Regarding Off-Site Improvement Obligations.

Except as otherwise expressly disclosed . . . or with respect to the Off-Site Improvements, as of the Contract Date only, (I) Seller has made no written agreement, representation or commitment to any Governmental Agencies or public authority, utility company, or school district relating to any portion of the Project, which agreement, representation or commitment shall impose an obligation upon Purchaser to (a) make any contributions or dedications of money or land; (b) construct, install or maintain any improvements of a public or private nature on or off the Project; or ⁹³ limit or restrict, to any specific plans other than . . . the development construction or use of the Project[;] and (ii) to the actual present personal knowledge of [named individuals], without any independent investigation or duty of inquiry, no predecessor-in-interest of Seller has made any written agreement, representation or commitment to any Governmental Agencies or public authority, utility company, or school district. . . . Purchaser shall have the burden of establishing such actual present personal knowledge in the event of any alleged breach of this representation.⁹³

5. Seller's Representation Regarding Endangered Species.

As of the Contract Date only, Seller has not sought any permits under, nor has Seller received any jeopardy letters or written notices of violations of, the Endangered Species Act (16 U.S.C. §§ 1531 *et seq.*) with respect to the Project, from the United States Fish and Wildlife Service, and except as disclosed to Purchaser . . . to the actual present personal knowledge of [named individuals], without any independent investigation or duty of inquiry, Seller is not aware of any reports confirming the presence of endangered species on the Project. Purchaser shall have the burden of establishing such actual present personal knowledge in the event of any alleged breach of this representation.⁹⁴

⁹³ *Id.* at 21-22, § 8.1.8.

⁹⁴ *Id.* at 23, § 8.1.15.

6. Seller's Representation Regarding Utilities and Utility Moratoria.

To Seller's knowledge, all utility services necessary for the development of the Property as a residential development and for construction and occupancy of the homes thereon (e.g., water, sewer, electricity, telephone, and if available to the Property, cable television and gas), will be available to the Property, and there is no pending moratorium on, or other impediment to, immediate sewer and water availability which is applicable to any portion of the Property nor, to Seller's knowledge, is any such moratorium contemplated or threatened.⁹⁵

7. Seller's Representation Regarding Recently Imposed Impact Fees.

To Seller's knowledge, there are no new (or increases in existing) development fees, impact fees or other fees that will be levied (or are under consideration by any Authority) which will affect the development of the Property as contemplated by Buyer and there are no matters or conditions affecting the Property that would prevent, materially increase the cost of, or materially impair residential development on the Property.⁹⁶

8. Seller's Representation Regarding Designation of Site as Historic District.

There is no actual or pending designation of all or any portion of the Property, or of the area or district in which the Property is located, as an historic district, site, building, battlefield, structure, object or other resource on the National Register of Historic Places or any other similar list or survey maintained by any federal, state, county, municipal or private authority [such that the Property or any portion thereof is or may become subject to development restrictions or prohibitions], nor does Seller have any knowledge that any such designation is contemplated. The Property does not contain any cemeteries or graveyards.⁹⁷

⁹⁵ Ryland Group Agreement of Purchase and Sale (Raw Land) 9, § 14b(v).

⁹⁶ *Id.* at 9, § 14b(vi).

⁹⁷ *Id.* at 11, § 14b(xvii).

9. Seller's Representation Regarding Floodzone Designation.

No portion of the Property is located in any flood zone, flood hazard area, flood plain or similarly designated zone on the applicable FEMA maps or in a "wetlands" area as defined by any Authority.⁹⁸

10. Buyer's Remedies for Seller's Curing of Breached Representations and Warranties.

Notwithstanding anything in this Agreement to the contrary, if any fact, condition or circumstance is actually known or disclosed to Purchaser at any time prior to or as of the Approval Date, and such fact, condition or circumstance contradicts or renders untrue any representation or warranty in Section __, then such representation or warranty shall be canceled, superseded and of no effect to the full extent of such contradiction or untruth. Furthermore, if at any time after the Approval Date and prior to Closing, Purchaser discovers a breach (or facts evidencing the reasonable likelihood of a breach) of any representation or warranty made in this Agreement by Seller, Purchaser shall (within fifteen (15) business days after discovery of such breach or facts) provide Seller with written notice thereof. Seller shall thereafter use commercially reasonable efforts, but only after the Approval Date, to cure or remedy any such breach within sixty (60) days of Seller's receipt of such notice (and the Closing shall be extended, if necessary, to enable Seller to cure any such breach within such sixty (60) day period). If Seller fails to cure any such breach of any representation or warranty first discovered by Purchaser after the Approval Date and prior to Closing, then Purchaser's sole remedy (which shall be exercised within ten (10) business days after the end of Seller's sixty (60) day cure period) shall be to either: (I) terminate this Agreement, upon delivery of written notice thereof to Seller, whereupon the applicable [liquidated damages provision] below shall apply; or (ii) to close Escrow and take the Project "AS-IS" with no further obligation or liability on the part of Seller as to the representation or warranty breached and without any reduction in the Purchase Price, escrow retention or other claim against Seller.⁹⁹

⁹⁸ *Id.* at 11, § 14b(xv).

⁹⁹ Agreement of Purchase and Sale by and between Redwood Shores Properties and SNS Equities, Inc. 23-24, § 8.2.

11. Documents Seller Is To Produce and Buyer's Acknowledgement of Receipt.

Seller shall deliver to Buyer copies of the following documents and records regarding the Property which are in Seller's or Seller's agents', representatives' or brokers' possession or control:

* * *

- (d) Copies of all permits and licenses for the Property;
- (e) Copies of all warranty agreements and guaranties, if any, which Seller may have covering any portion of the Property;
- (f) Copies of all existing soil reports, all existing environmental reports, all existing engineering reports, all existing surveys and all existing traffic studies applicable to the Real Property to the extent Seller is in possession of same;
- (g) Copies of all agreements and leases affecting the Property;
- (h) Copies of all settlement agreements or other documents which currently have an effect on the Property. . . ;
- (i) Conceptual plan . . . showing proposed bus turn-out on _____ Expressway frontage of the Property (the "Bus Turn-Out").

Buyer acknowledges having received from Seller copies of the following materials. . . :

* * *

- (k) Phase I Environmental Site Assessment prepared by _____ dated _____ (the "Phase I Study");
- (l) Phase II Environmental Site Assessment prepared by _____ dated _____ (the "Phase II Study");
- (m) Market Study prepared by _____ dated _____;
- (n) Photocopies of portions of an Illustrative Site Plan by _____, architects;
- (o) The following correspondence with _____, Director of Planning;
- (p) Memorandum from _____ County Planning Department dated _____ authorizing tree removal.

Seller makes no warranty, express or implied, as to the validity or accuracy of items delivered to Buyer pursuant to this Subparagraph _____.

Buyer accepts full liability for any claims by consultants arising from

Buyer's use of items delivered to Buyer pursuant to Subparagraph _____ of this Agreement. Buyer hereby agrees to obtain a consultant's consent before using that consultant's material in a manner which may require such consent related to items delivered to Buyer pursuant to Subparagraph _____ of this Agreement, and Buyer agrees that it is Buyer's responsibility to contact any consultants retained by _____ City Development for the purpose of obtaining any additional material.

Seller shall promptly provide to Buyer such other documents or information regarding the Property as Buyer reasonably requests.¹⁰⁰

12. Feasibility Study.

Buyer shall have the right during the Feasibility Period, to investigate title and to make such investigations, studies and tests with respect to the Property as Buyer deems necessary or appropriate to determine the feasibility of purchasing the Property. At any time prior to the expiration of the Feasibility Period, Buyer may, in its sole discretion, terminate this Agreement by written notice to Seller. Upon termination of the Agreement, Seller shall direct the Escrow Agent to return the Earnest Money to Buyer. Thereafter no party hereto shall have any further obligation or liability to the other with respect to the transactions contemplated by this Agreement except for Buyer's indemnification of Seller pursuant to subsection ____ hereof, which shall survive termination of this Agreement.¹⁰¹

13. Condition Regarding Executory Period Changes Affecting Feasibility.

Buyer shall, in Buyer's good faith determination, be satisfied that since the end of the Feasibility Period, the environmental conditions relating to the Property have not changed such that Buyer is subject or otherwise potentially exposed to any (I) fee, expense, cost, obligation or liability in regard to the Property or (ii) impairment to Buyer's construction operations or marketing efforts with respect to the Homes, by reason of

¹⁰⁰ Derived from Agreement for Purchase and Sale of Real Estate by and between McTavish Corporation and Lincoln Property Company 6-8, § 2.5.1.

¹⁰¹ Ryland Group Agreement of Purchase and Sale (Raw Land) 3, § 4a.

(A) any information set forth, or omitted to be addressed, in any environmental audit on the Property; or (B) any existing condition or condition perceived by the general public to exist (although not necessarily existing in fact) on any portion of the Property or in the general geographical area wherein the Property is located, which existing condition or perceived condition raises any health or environmental issue with respect to the Property or such geographical area.¹⁰²

14. Purchaser Assumption of Regulatory Risk (FDIC form).

Seller makes no representations or warranties and shall not in any way be liable for any representations or warranties, including, without limitation, representations and warranties with respect to: (I) the condition of the premises or any buildings, structures or improvements thereon or the suitability of the premises for habitation or for Purchaser's intended use or for any use whatsoever; (ii) any applicable building, zoning or fire laws or regulations or with respect to compliance therewith or with respect to the existence of or compliance with any required permits, if any, of any governmental agency; (iii) the availability or existence of any water, sewer or other utilities (public or private); (iv) the existence, accuracy, or validity of any documents with respect to the premises (including, without limitation . . . permits issued by governmental entities having jurisdiction over the premises . . . or soil reports). . . . Purchaser acknowledges to Seller that Purchaser has fully inspected the premises or will do so prior to the expiration of the approval period to its full satisfaction, and Purchaser assumes, as of closing, the responsibility and risk of all defects and conditions, including such defects and conditions, if any, that cannot be observed by casual inspection."¹⁰³

Further inspection. Purchaser acknowledges that Purchaser is relying on its own examination and inspection of all matters with respect to taxes, bonds, permissible uses, zoning, covenants, conditions and restrictions and all other matters bearing upon the value of the Premises in Purchaser's judgment and for Purchaser's purposes, and not on any

¹⁰² *Id.* at 7, § 8e.

¹⁰³ *Louis Scherzer Partners v. FDIC*, 885 F. Supp. 1415, 1416 (D. Or. 1995).

representation of Seller or of Seller's agents or employees, and Purchaser waives any claim on that account.¹⁰⁴

15. Closing Conditions on Planned Development Approval.

The closing of the sale of the Property in accordance with the terms of this Agreement (the "Closing") shall occur on the date (the "Closing Date") which is the earlier of a) sixty (60) days following approval of Planned Development Permit (the "PD Permit") by the applicable governmental authorities for Buyer's planned development or b) one (1) year from the Effective Date, or on such other date as is mutually agreed upon between Seller and Buyer.¹⁰⁵

16. Buyer's Obligation to Obtain Planned Development Permit.

Buyer shall diligently and in good faith pursue approval of the PD Permit and all other necessary approvals by the appropriate authorities for the Buyer's proposed development on the Property (collectively, the "Approvals"). In the event that Buyer has not submitted an application for planned development zoning which has been accepted as complete or which is deemed complete pursuant to _____ on or prior to the date which is six (6) months following the Effective Date, the Seller may, at its election either (I) terminate this Agreement by written notice to Buyer in which event the Earnest Money Deposit, together with any interest earned thereon, and the Permit Approval Deposit, if delivered, shall be retained by Seller, and the rights and obligations of the parties hereunder shall terminate, or (ii) proceed with the transaction as contemplated herein.¹⁰⁶

17. Limitation of Seller Remedies on Buyer Default.

If Buyer is the defaulting party, because of the difficulty in calculating damages, the parties agree that Seller's sole and exclusive remedy at law or in equity shall be limited to the right to terminate this Agreement and retain the Deposit as liquidated damages. Other than the specific

¹⁰⁴ *Id.*

¹⁰⁵ Agreement for Purchase and Sale of Real Estate by and between McTavish Corporation and Lincoln Property Company 3, § 2.4.1.

¹⁰⁶ *Id.* at 17, § 2.7.

remedy expressly set forth in this section, Seller hereby waives any and all right and remedy, at law or in equity, to which Seller may otherwise have been entitled by reason of Buyer's default, including any right in equity to seek specific performance of this Agreement by Buyer and any right at law to seek damages from Buyer.¹⁰⁷

18. Purchasers' Right to Compel Seller to Repurchase Any Unusable Lot.

Defective Lot. Following any Closing in the event that Buyer, through no fault of Buyer, (a) cannot secure all required permits for construction of the Product upon any Lot which was the subject of such Closing; (b) discovers fill materials unsuitable to support standard housing footings; or (c) cannot use a Lot for its intended purpose, then such Lot shall be deemed a "Defective Lot" and Buyer shall have the right to reconvey such Lot to Seller. The purchase price to be paid by Seller to Buyer for any such Defective Lot shall be the Purchase Price per Lot paid therefor by Buyer plus any and all recording costs and settlement costs paid by Buyer therefor and any costs incurred by Buyer related to construction on the Lot through the date that Buyer determines that the Lot is defective. In the event a reconveyance to Seller of a Defective Lot occurs hereunder, then Seller shall bear the entire cost of any (a) recording fee and lien certificate and (b) state, county or other recordation tax, documentary stamp tax or other transfer tax incurred in recording the deed to any such Defective Lot. Additionally, the provisions of Section __ shall similarly apply to such reconveyance transaction, but the words "Buyer" and "Seller," respectively, as the same appear therein, shall read "Seller" and "Buyer," respectively. This Section __ shall survive each Settlement.¹⁰⁸

19. Condemnation Prior to Closing.

Seller warrants that there is not pending, or to the best of Seller's knowledge, threatened, any condemnation proceeding or eminent domain action relating to the Property. Closing is conditioned upon the veracity of Seller's warranties and representations.

¹⁰⁷ Ryland Group Agreement of Purchase and Sale (Raw Land) 7, § 11a.

¹⁰⁸ *Id.* at 10, § 13.

If prior to Closing, any portion or all of the Property is taken or threatened to be taken by condemnation or eminent domain, Buyer, in Buyer's sole discretion, may either (A) terminate this Agreement or (B) consummate this Agreement, in which event Seller shall pay and assign to Buyer any and all awards made or to be made in connection with such condemnation or eminent domain action.¹⁰⁹

If prior to any Closing, any portion of the Property is taken by any entity by condemnation or with the power of eminent domain, or if the access thereto is reduced or restricted thereby (or is the subject of a pending taking which has not yet been consummated), Seller shall immediately provide written notice to Buyer of such fact. In such event, Buyer shall have the right, in Buyer's sole discretion, to terminate this Agreement upon written notice to Seller and Title Company not later than seven (7) days after receipt of Seller's notice thereof. If this Agreement is so terminated, all documents and funds, including the Deposit, shall be returned by Title Company to each party who so deposited the same without further instructions to the Title Company, and neither party shall have any further rights or obligations hereunder, except for payment of Title Company cancellation fees which shall be borne equally by Buyer and Seller. Alternatively, Buyer may proceed to consummate the transaction provided for herein at Buyer's sole election, in which event Seller shall assign and turn over, and Buyer shall be entitled to receive and keep, any and all awards made or to be made in connection with such condemnation or eminent domain, and the parties shall proceed to the applicable Closing pursuant to the terms hereof, without any reduction in the Purchase Price.¹¹⁰

20. Regulatory Takings and Zoning Changes Prior to Closing.

Seller warrants that there is not pending, or to the best of Seller's knowledge, threatened, any change in existing zoning law applicable to the property. Closing is conditioned upon the veracity of Seller's warranties and representations.

¹⁰⁹ Deborah B. Paslin, Agreement for Purchase and Sale of Real Property, (unpublished paper, University of Southern California Law School, Fall 1997) (from Kaufman and Broad Agreement of Purchase and Sale (June 28, 1995) and Ryland Group Agreement of Purchase and Sale (Finished Lots) (June 28, 1995)).

¹¹⁰ Kaufman and Broad Agreement for Purchase and Sale of Real Property 13.

Seller agrees to assign all rights to any award from condemnation or eminent domain and all claims, counterclaims, defenses or actions to the Buyer.

Seller agrees to join Buyer, at Buyer's sole request and expense, in an action to recover any and all of the award for any regulation applicable to the Property. Any such award is reserved for the Buyer.¹¹¹

¹¹¹ Deborah B. Paslin, *Agreement for Purchase and Sale of Real Property* (unpublished paper, University of Southern California Law School, Fall 1997) (from Ryland Group Agreement of Purchase and Sale (Finished Lots) (June 28, 1995) and Ryland Agreement of Purchase and Sale (Finished Lots) (June 28, 1995)).

