Ginger

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INTERAGENCY
Richard B. Nicholls, Commissioner
Arizona State Real Estate Department
1645 West Jefferson Street
Phoenix, Arizona 85007

I80-206 (R80-269)

Dear Mr. Nicholls:

You have asked whether certain provisions of the newly-enacted Groundwater Management Law (Ch. 1, Fourth Sp. Session 1980, Laws of 1980) are applicable to subdividers in an active groundwater management area who had complied with all local requirements and had commenced construction prior to the effective date of the legislation.1/ Specifically, you want to know whether the subdivider must obtain a Certificate of Assured Water Supply from the Director of Water Resources (pursuant to A.R.S. § 45-576.E), before you can issue a Public Report authorizing the sale of subdivided lands. It is our opinion that although the Certificate requirement is generally applicable to the subdividers you describe, the subdividers may have "vested rights" under prior law which might, in limited factual circumstances, serve to exempt them from the new requirement.2

Two provisions in the new groundwater code prohibit the Real Estate Commissioner from issuing a Public Report allowing a person to sell subdivided land unless the subdivider has obtained a Certificate of Assured Water Supply. The first provision is Chapter 1, Section 13, of the Act, which adds the following language to A.R.S. § 32-2183:

> C. If the subdivision is within a groundwater active management area, as defined in Section 45-402, the Commissioner shall deny issuance of a Public Report unless the owner, agent or subdivider has been issued a Certificate of Assured Water Supply by the

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1/ We assume you are referring to subdividers who do not qualify for a statutory exemption under A.R.S. § 45-576.D. or E.

2/ It is clear that under prior law a Public Report would probably have been issued.

> Director of Water Resources, or unless the subdivision is located within an area designated as having an assured water supply by the Director of Water Resources pursuant to Section 45-576, Subsection D or E.

Similarly, the groundwater code in Chapter 1, Section 86, sets forth the same requirement in the following terms:

> <u>§ 45-576(D)</u>.
> The state real estate commissioner may issue a public report authorizing the sale or lease of subdivided or unsubdivided lands only if the subdivider, owner or agent has obtained a Certificate of Assured Water Supply from the Director, unless the lands are located within an area designated as having an assured water supply pursuant to subsection D or E of this section.

On its face, the new law would appear to apply to any and all subdividers who, as of the effective date of the groundwater code, had not yet obtained a Public Report pursuant to A.R.S. § 32-2183, authorizing the sale or lease of lots. However, there is a substantial body of case law holding that, in limited circumstances, a developer may secure a vested right to continue a project in accordance with the law existing at the time the project was commenced, and escape the requirements of new or amended laws. The question, then, is whether the changes in the groundwater law apply to developers whose projects were substantially enough completed so that they might have obtained some "vested rights" prior to June 12, 1980, the effective date of the groundwater code.

The existence of "vested rights" in the context of real estate development is not a new idea in Arizona and was first discussed in <u>City of Tucson v. Arizona Mortuary</u>, 34 Ariz. 495, 272 P. 923 (1928). In that case, Arizona Mortuary obtained a building permit and entered into a construction contract before it learned of a pending change in the law which would have rendered unlawful its operation of a mortuary in a residential district. The Supreme Court held that performance of substantial construction work might have given Arizona Mortuary a vested right to complete the mortuary and operate it in a residential area, but that the mere acquiring of the property and obtaining of a building permit were insufficient to grant any vested right. 34 Ariz. at 511. Substantially all of the construction was done after the mortuary operator had learned of the possibility of a zoning change.

A similar conclusion was reached in Verner v. Redman, 77 Ariz. 310, 271 P.2d 468 (1954). In this case, which was factually similar to Arizona Mortuary, a developer obtained a building permit to construct a gasoline service station at the intersection of 7th Avenue and Glendale in what is now part of Phoenix. Before any substantial construction was done (the site was cleared, footings were dug, and foundation forms were put in place, but no foundations were poured), the developer was advised that zoning law had been changed to prohibit construction of a gasoline service station at that site and the previously issued building permits were revoked. The Supreme Court ruled that the developer obtained no vested rights to complete construction, since the amount of work done prior to the change in the law was of small consequence.

A more recent case discussing the necessity of there being substantial expenditures in order to obtain vested rights is Town of Paradise Valley v. Gulf Leisure Corporation, 27 Ariz.App. 600, 557 P.2d 532 (1976). In Gulf Leisure, the developer had acquired property for the construction of a resort hotel. Additionally, the developer had expended substantial sums for architectural fees, feasibility studies, overhead expenses, building permits, and clearing of land (totalling $348,000 over and above acquisition costs of land). Gulf Leisure Corporation had obtained a building permit and commenced site work but, due to financial difficulties, actual construction was delayed. The building permit had an express termination date but provided for renewals. A timely renewal was subsequently sought but was rejected by the Town of Paradise Valley due to a zoning change which had increased the minimum acreage requirements for resort hotels from 15 to 20 acres. The real property in controversy consisted of 18.844 acres. The court concluded that the expenditure of substantial funds in connection with development of the project, even though it was not actually expended for construction, was sufficient to give the developer a vested right to continue its project under the laws existing at the time the permit had originally been issued.

More recently, the Arizona Supreme Court has made it clear that expenditures going solely to acquisition of land are insufficient to give any vested rights. Dawe v. City of Scottsdale, 119 Ariz. 486, 581 P.2d 1136 (1978). In that case the court held that a developer who had a recorded subdivision plat was not immune from a subsequent zoning change, increasing the minimum lot size in the City of Scottsdale. The denial of building permits to the developer for its substandard-sized lots was upheld. The case was distinguished from the Supreme Court's earlier decision in Robinson v. Lintz, 101 Ariz. 448, 420 P.2d 923 (1966). In that case the subdivider submitted her plat to the County Board of Supervisors for approval and wished to commence construction. The Board of Supervisors delayed approving the plat, refused to issue building permits, and ultimately rezoned the property, increasing the minimum lot-size requirements beyond the size of the lots in the developer's submitted plat. In Robinson, the court concluded that the developer had obtained a vested right even though no substantial expenditures beyond acquisition of the property had been made. In denying the vested rights claim in Dawe, the Supreme Court distinguished Robinson on the basis that the developer in Robinson wanted to commence construction prior to the change in the law, but was prohibited by the county's wrongful refusal to issue building permits. In Dawe, no effort had been made to obtain building permits for a period of three years after the plat had originally been approved.

One final "vested rights" case is pertinent to the present problem. While it involves formation of a power district rather than development of real estate, it is helpful since it deals with a two-tiered approval system analogous to the real estate subdivision laws which require both local and state approval. In re Dos Cabezas Power District, 17 Ariz.App. 414, 498 P.2d 488 (1972), involved the question of whether or not persons seeking to form a power district within Cochise County had obtained a vested right to complete formation of the district. The applicable law required, first, that approval be obtained from the County Board of Supervisors and, second, that creation of the district be approved at a general election. After approval by the Board of Supervisors but prior to the election, the Governor signed emergency legislation which effectively precluded the final formation of the power district in question. The court concluded that the right to form the power district had not become vested since, at the time of the enactment of the emergency legislation, formation still depended upon a favorable vote at the polls. The court provided the following analysis of the "vested rights" issue:

> Rights are vested, in contradistinction of being expectant or contingent. They are vested, when the right to enjoyment, present or prospective, has become the property of some particular person or persons as a present interest. They are expectant when they depend upon the continued existence of the present

> condition of things until the happening of some future event. They are contingent, when they are only to come into existence on an event or condition which may not happen or be performed until some other event may present their vesting. Id. at 418.

These Arizona decisions uniformly require a three-part showing before rights become vested. First, the developer must show a substantial expenditure in connection with the project. Verner v. Redman, supra; City of Tucson v. Arizona Mortuary, supra; Town of Paradise Valley v. Gulf Leisure Corporation, supra. This expenditure must be in addition to the cost of acquiring the real property. Dawe v. City of Scottsdale, supra. Second, it must be shown that the developer was acting in ignorance of the proposed change in the law when the substantial expenditures were made. Verner v. Redman, supra; City of Tucson v. Arizona Mortuary, supra. Both of these requirements could be met in the case of developers who had commenced construction but failed to obtain subdivision sales approval prior to the change in the law. Finally, each of the decisions finding vested rights, or even suggesting that vested rights could exist if substantial construction had been completed, involved developers who had either obtained all necessary permits prior to the change in the law (Verner v. Redman, supra; City of Tucson v. Arizona Mortuary, supra; Town of Paradise Valley v. Gulf Leisure Corporation, supra), or at least had filed all necessary applications to obtain approval before the change in the law (Robinson v. Lintz, supra). When all necessary permits and approvals had not been obtained, vested rights were found not to exist. In re Dos Cabezas Power District, supra. This third requirement for a finding of vested rights is the one which has not been met under existing case law.

In enacting the new groundwater code, the Legislature chose to make the approval of the Real Estate Commissioner the controlling factor in prohibiting further development if inadequate water supplies exist. Developers who had not filed for approval to sell their subdivided lands prior to the enactment of the new legislation, have not clearly acquired vested rights under current case law. Unless the Arizona courts would modify or extend prior decisions to apply the "vested rights" theory to developers who had not eliminated the final major contingency to the marketing of their property, those unwary developers "caught" by the new groundwater code requirements will have no recourse other than petitioning the Legislature for amendments to the law.

While we cannot predict with certainty what a court will decide, there appears to be reasonable likelihood, however, that the Arizona courts would extend the "vested rights" doctrine in an appropriate fact situation. The developers stand to lose substantial investments made in good faith in reliance on the continuation of prior law, and historically, the courts have expanded the doctrine when sufficient hardship was shown.3/ For example, while earlier cases talked about substantial construction being required (e.g., Verner v. Redman, supra) and have even held that the construction must be done at the site of the real property (Phoenix City Council v. Canyon Ford, 12 Ariz.App. 595, 473 P.2d 797 (1970), holding that costs incurred in manufacturing a sign did not give a vested right to erect that sign in contravention of a sign ordinance passed subsequent to manufacture), the court in Town of Paradise Valley v. Gulf Leisure Corporation, supra, considered both the cost of acquiring the property and expenses other than actual construction in finding that vested rights existed.

Similarly, in Robinson v. Lintz, supra, the Arizona Supreme Court carved out an exception to the requirement that all permits be obtained prior to vested rights coming into existence and held that the mere filing of an application for the necessary permits was sufficient.

3/ Should the courts subsequently decide to extend the "vested rights" theory to encompass subdividers who have made substantial investments in good faith, we assume it would do so by interpreting the groundwater code so as not to apply to these developers. Courts must, if possible, construe the language of a statute to be constitutional and valid. Roberts v. Spray, 71 Ariz. 60, 223 P.2d 808 (1950). This rule of construction is particularly pertinent to the groundwater code, which has a non-severability clause. Chapter 1, Section 172 ("If any portion of this act is finally adjudicated invalid, the entire act shall be null and void.").

Inasmuch as there is no Arizona case dealing with this particular situation, we can only give our best judgment as to how the Arizona courts might treat these issues. When considered with that caveat, we think that you and the Director of Water Resources might reasonably conclude, on the basis of the standards discussed above4/ and in anticipation of how the Arizona courts might treat this issue, that a particular developer in an appropriate fact situation, as you determine it,

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4/ Following is a summary of those standards:

1. The developer must have a substantial expenditure beyond the original cost of acquiring the property. Verner v. Redman, supra; City of Tucson v. Arizona Mortuary Corporation, supra. The expenditures need not be limited exclusively to construction costs, but may include site preparation, construction of off-site improvements, or conversion or remodelling costs for existing structures. Town of Paradise Valley v. Gulf Leisure Corporation, supra.

2. The developer was acting in ignorance of the proposed change in the groundwater law when it made its substantial expenditures. Verner v. Redman, supra; City of Tucson v. Arizona Mortuary Corporation, supra.

3. When the "vested rights" were acquired, the project was otherwise able to comply in all respects with existing law. Robinson v. Lintz, supra. This is not to say that all necessary permits had already been obtained but, rather, that the project was eligible for approval at all levels, both state and local, at the time the "vested rights" were obtained and that the project had already obtained substantially all of those permits. Town of Paradise Valley v. Gulf Leisure Corporation, supra.

has acquired a vested right to subdivide under prior law and is therefore not subject to the newly enacted certificate requirement.5/

It is incumbent upon the developer to demonstrate that substantial expenditures were made in good faith and in ignorance of the proposed changes in the law. These expenditures can include construction, renovation, off-site construction, or any other substantial expenditures related to development of the property.

Sincerely,

Bob Corbin

ROBERT K. CORBIN
Attorney General

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5/ Thus, the Director of Water Resources would issue a report under former A.R.S. § 45-513, indicating the adequacy or inadequacy of the water supply, and the Real Estate Commissioner would include in his Public Report a statement noting any lack of adequate water supply, as would have been done prior to enactment of the groundwater code or would still be done for subdivisions not in active water management areas.