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Development Agreements and stop orders – an indelicate imbalance

Case commentary on *Focaccia Holdings and 1681625 Alberta Ltd. v. Parkland Beach* (2014 ABCA 132) May 2014.

Facts

Focaccia Holdings Ltd. ("Focaccia") entered into a Development Agreement with Parkland Beach for a 75 lot subdivision which provided, amongst other things, that roadways on completion would be surfaced with asphalt. Inadequate financial resources prevented completion of the roadway surfacing. A number of the lots within the subdivision had been sold and those that remained in possession of Focaccia at the time of issuance of the stop order to Focaccia were transferred to the co-appellant, 1681625 Alberta Ltd., a company incorporated by the directors of Focaccia. A stop order was also issued to 1681625 Alberta Ltd. Titles to the lots in the subdivision were all subject to a caveat filed pursuant to the Development Agreement required as a condition of the subdivision approval. The Development Agreement contained a number of conditions, including a provision which made the Development Agreement a first charge upon the lands.

Issues

The two issues considered by the Court were: (1) whether or not the statutory remedy of a stop order available pursuant to s.645 of the *Municipal Government Act* ("MGA") which provides for the issuance of a stop order where a use of land is not in accordance with "a development permit or subdivision approval" extended to the Development Agreement; and, (2) whether or not a purchaser from the developer is also subject to a stop-order for an alleged default of the Development Agreement where there was no assignment of the Development Agreement.

The genesis of Development Agreements

Until the early 1970s, the servicing and construction of all public infrastructure within new subdivisions was completed by the municipality. The cost of such infrastructure was then recovered by the municipality through the imposition of local improvement charges on each lot recoverable over a lengthy period of time. In the early 1970s it became evident this was taxing both the financial and human resources of the municipality, and arrangements were concluded to enable the private sector to assume direct responsibility for the municipal improvements. This relieved the municipality of the burden, the cost and the risk associated with the installation of municipal improvements. However, in order, to enable the developer to complete the servicing, the lending institution advancing the cost of servicing required security, a need generally satisfied by the registration of a mortgage against the lots resulting upon registration of the subdivision plan following the execution of the Development Agreement. Consequently, under the *Municipal Government Act* municipalities were authorized, as a condition of subdivision approval, to require that the applicant "enter into an agreement with a municipality" to construct or pay for the construction of the municipal improvements (s. 655 MGA). The conditions of subdivision approval are satisfied by entering into the agreement, enabling the Plan of Subdivision to then be registered (s.657 MGA). The municipality is not authorized to impose, as a condition of subdivision approval, that the services be completed as this would delay registration of the subdivision and undermine the security for financing of the improvements. The municipality receives a contractual commitment of the developer for completion of the municipal infrastructure within the subdivision. Concerned that the developer may not complete the improvements, municipalities were granted the right to require the developer provide security for performance of the agreement. Additionally, municipalities are entitled to register a caveat with respect to the Development Agreement. The precise purpose or impact of these caveats has not been considered by the courts and consequently remains unsettled.

Effectively, in consideration of relieving a municipality of the obligation to install the services and improvements, the municipality agreed to accept the contractual commitment of the developer, duly secured to ensure performance. This system, while not perfect, has worked effectively over the past 40 years and for the first 40 years predating Focaccia, the question of whether or not a stop order superseded the sanctity of the Development Agreement had not become the subject of judicial review issue.

Stop orders

Stop orders are authorized under Section 645 of the MGA which states:

> If a development authority finds that a development, land use or use of a building is not in accordance with … "(b) a development permit or subdivision approval," the development officer may issue a stop order.

In issuing a stop order, the municipality may stop the development or direct the person in possession of the land to stop the development, or use or carry out any other actions required by the notice so that the development or use of land complies with the MGA. (s. 645 MGA).

The failure to comply with a stop order is an "offence" under (s.557(a.3) MGA) rendering a breach of contract the foundation for quasi criminal conduct. In addition, the municipality is authorized to enter upon the land to carry out whatever work may be required and to add the cost of such work to the tax roll for the lands. (s.553(1)(h.i) and s.646(1) MGA).

The debate

In this case there was clearly noncompliance with the development agreement that required asphalt to be placed on the roadways. The Developer argues that failure to comply with the development agreement was not a failure to comply with the conditions of subdivision approval which only required the Developer to enter into the Development Agreement. The Summer Village argued that the intent of the condition imposing a requirement for the Development Agreement was to ensure that ultimately the roadways within the subdivision would be constructed and the work would be performed at the developer's cost. Therefore, it was an overly technical and restrictive interpretation to conclude that the subdivision approval did not incorporate by reference each of the provisions of the Development Agreement. This language of the MGA was determined to be broad enough that a subdivision approval incorporates the terms of the Development Agreement. Having regard to the object of the statute, the Court of Appeal concluded that a stop order could be issued to enforce the provisions of a Development Agreement. The MGA authorizes the issuance of a stop order where the development is "not in accordance with" a subdivision approval. It assumes the subdivision approval includes the Development Agreement. If the conditions of subdivision approval include the Development Agreement, and fulfilment of the conditions is a prerequisite to registration of the plan, arguably the subdivision officer can delay plan endorsement under Section 657 of the MGA pending fulfilment of the terms of the Development Agreement? The Summer Village interpretation assumes that the sole purpose of the MGA is to have the infrastructure completed at the Developer's cost, while overlooking the fact that the legislation was designed to also enable the Developer to finance such costs. To require the Developer to construct infrastructure at significant cost without means to finance the improvements undermines the ability to get the work done.

The Court held that to deny the use of a stop order to enforce a Development Agreement would undermine the role of the Development Agreement as an important regulatory mechanism. Quoting Laux' "Planning Law and Practice in Alberta", the Court states:

> "The only time that a stop order is needed is with respect to matters like the installation of infrastructure, as pure conditions relating to subdivision are enforced by refusing registration of the plan at Land Titles Office."

This unfortunate statement improperly captures the nature of the stop order. A stop order may be required to stop premature implementation of a subdivision where such work is commenced prior to the execution of the Development Agreement. Following the execution of the Development Agreement, the municipality should be in possession of sufficient security under Section 655(1)(b)(vi) of the MGA to enforce the agreement. Prior to the execution of the Development agreement there is one owner affected and one title which is noncompliant with the s. 645 of the MGA. After the registration of the plan, conceivably there would be many owners owning a number

of parcels none of which were the roads that required asphalt. The new lots resulting on subdivision were not noncompliant with the Development Agreement and should not warrant a stop order on that account alone.

The Court concluded that, if the condition of subdivision approval had required the applicant to pave the roads, it would have been enforceable by stop order. Simply because the developer entered into a contract to do so should not change the remedy available to the municipality. With respect, the MGA does not authorize the imposition of a requirement to pave the roads or install the improvements as a condition of subdivision approval – only that the developer enter into an agreement to complete such roads.

The Court further states that it would be impractical to include in the subdivision approval all of the terms of the Development Agreement so the agreement is required to capture all terms of the approval. The conditions of subdivision approval which are authorized do not provided that the Developer is to install the services, only that the Developer enter into an agreement to do so. To impose the terms of the Development Agreement in the subdivision approval would result in an invalid subdivision approval and dismisses the importance of the agreement and plan registration.

The Court presumed that the concurrent registration of the plan and the execution of the Development Agreement were designed to expedite the subdivision process. Given that servicing is going to take a number of months (usually over two years), registration of the subdivision plan in the interest of expediting the subdivision process is of limited value.

In response to the argument that the municipality should be obliged to exhaust its contractual remedies prior to issuing a stop order, the Court concluded that because there are no words of limitation either in the MGA or in the Development Agreement regarding use of statutory remedies, it would be open to the municipality to exercise whichever remedy it deemed appropriate. Only if the legislature thought a stop order was authorized for noncompliance with the Development Agreement would words of limitation have been required in the MGA.

The Court recognizes that a stop order may not be the most appropriate remedy where the breach is of a minor nature or a technical nature, suggesting that arbitration may be a more appropriate remedy in some circumstances. Given that the stop order entitles the municipality to recover all of its enforcement costs in priority to other creditors, a stop order will likely be seen by most municipalities to be the most appropriate remedy. The Court of Appeal has concluded that the municipality may issue a stop order even where it holds other security under the Development Agreement, unless the Development Agreement otherwise provides.

If one considers the broad purpose of Section 655 of the MGA authorizing the execution of the Development agreement as a condition of subdivision approval, it is not only to require that the infrastructure be ‘constructed’ – it has historically provided a mechanism whereby the developer can finance the construction of those improvements. Discretion in the municipality to delay the subdivision was eliminated at the registration stage. Allowing the municipality to issue a stop order while obligations remain outstanding under the Development Agreement in the face of the contractual remedies provided in the contract as well as the security for the performance of those obligations, jeopardizes the ability of the developer to obtain financing for the construction cost of the servicing, as does the ability to add the costs of the municipality performing the obligations under the Development Agreement to the tax roll and taking priority to the financing in place.

A developer’s perspective

A stop order in the normal course issued in relation to a development permit requires an assessment of the conditions of the development permit issued by the development officer. It is issued to a private owner in respect of private development upon private land based on public law. It affects one owner and potentially its lender. Issuing a stop order in respect of servicing under a subdivision after the subdivision plan is registered contemplates directing the installation of public infrastructure upon public lands affecting potentially many owners, their lenders and others. How can the stop order be issued in relation to lots unless they are non-compliant with the Development Agreement and where is it that the paving in Focaccia was to be placed on the lots in question? If the stop order is to be issued where, for example, the paving is not completed, as in Focaccia,

in respect of which lots should it be issued? Should it be only lots against which a caveat is then registered? Should it be all lots? Should it be only those lots conveyed after the issuance of the initial stop order, and those lots alone become solely responsible for paying the costs of paving all roads within the subdivision?

At the point that the stop order is issued, it is quite likely that the developer has invested substantially in the land, has made a commitment to pay contractors to install the services, and, hopefully, will have presales in place – all of which are at risk because the development officer has determined that some element of the Development Agreement has not been complied with. The only question before the development officer is whether or not he "believes" that there is a default in compliance with the Development Agreement. What investigation precedes the issuance of the stop order is up to the development officer. No investigation or notice is required. There is an appeal to the Subdivision and Development Appeal ("SDAB") which can override the issuance of the stop order within about six weeks, if the Board deems it appropriate. The cost of stopping work in mid-stream and remobilizing at a subsequent date when millions of dollars are at stake is substantial. The development officer, on the other hand, has little or no risk and little cost associated with stopping the development in order to remedy what he perceives to be a deficiency. In fact, the development officer will frequently have greater risk by not issuing the stop order. A municipality has a responsibility to take security sufficient to remedy defects and deficiencies in work improperly done or not done at all. That is why the municipality was given the authority to take security. To sit on security and to concurrently issue a stop order, while the developer and its lender and others suffer the exposure and stigma of a stop order, is not a reasonable burden to visit upon the developer, its lender or its purchasers.

The development officer, generally speaking, is trained in the administration of his public office. He is not trained in the recovery, analysis, and interpretation of evidence, nor in the interpretation and analysis of contracts and contract law. Moreover, it is not clear that he will be entirely unbiased in his assessment. It is a far different thing to interpret the provisions of a contract, engineering drawings, and matters of that substance, than to determine whether or not a building is constructed too high or too close to the boundary of the property line, or whether or not it is being constructed without a permit at all.

Effectively, the issuance of a stop order operates as an interim injunction at least until an appeal of the matter can be heard by the SDAB. If the development officer is generally ill-equipped to deal with gathering and interpreting evidence and interpreting contracts and understanding contract law, SDAB's across the province are generally less able to do so. They have not been trained in, nor are they generally experienced in, matters pertaining to subdivision approval at all. Inevitably, where there is uncertainty on the part of the SDAB as to whether the developer or the subdivision and development officer is correct, there can be little doubt that they will exercise caution and support the stop order. Members of the SDAB tend to be selected primarily because they have the ability to assess whether or not a variance from the zoning bylaw is warranted, or whether it will adversely affect the use and enjoyment of neighbouring properties. The SDAB's skill in dealing with detailed contracts and engineering evidence pertaining to those contracts in the context of subdivision is less certain.

Development Agreements have become vehicles for provisions that extend beyond the legislative authority of municipalities. Development Agreements are legislatively authorized to require the construction of municipal improvements. But a number of provisions are frequently inserted into Development Agreements well beyond what might normally be found in a construction contract. By way of example, the legal costs incurred by the municipality are frequently required to be paid by the developer. Adding to the taxes all costs of remedying the default, including payments for unauthorized levies, gives priority to such costs over the position of the lender who advances funds in good faith to implement the servicing. It is doubtful that this is what the legislature intended.

Effect of stop order on purchaser

In Focaccia, the stop order was also issued to the purchaser of a number of lots. There was no evidence that the Development Agreement had been assigned to those purchasers.

The Development Agreement was protected by caveat and therefore each purchaser was put on notice that there was an outstanding agreement between the developer and municipality which the Court of Appeal then states is "a charge on the lands". The court states that "it is incumbent on any purchaser to make inquiries on the status of that encumbrance just as a purchaser would have to inquire about any other encumbrance. An inquiry would quickly have disclosed that the covenant to pave the roads was still outstanding…"

Section 655(2) which authorizes the registration of the caveat is silent on the intended affect. The MGA merely allows it to be registered and requires it to be discharged upon completion of construction of the services. It is not clear what made it a charge on the lands or if it was ever intended that subsequent lot purchasers would be expected to perform any of the obligations which the developer assumed under the Development Agreement. Moreover, municipalities are not set up to advise on the status of each Development Agreement for each lot sale, particularly since the status of work is a moving target. When I last inquired of a municipality what obligations the lot purchasers assumed in connection with the caveat recorded on title, I was advised that the municipality does not provide that information. Certainly there is no administrative mechanism set up to respond to those inquiries or to the security held by the municipality for compliance. Advice on the security provided to protect the performance may be deemed by the municipality to be private information. It is unlikely that such information would be readily forthcoming. Caveat emptor applies in the case of Development Agreement caveats.

In any event, the Court is not clear on the consequences to the public of such a caveat or what obligations, if any, run with the land. Construction contracts by nature impose positive covenants, not negative covenants. Historically, positive covenants, which would include virtually all matters in the Development Agreement such as installing or paying for improvements do not run with the land.

The Court held that a municipality could require, as a condition of issuing a development permit, that the cost of works in respect of each lot be paid by the Applicant (s. 650 MGA). Unfortunately, this may be an accurate assessment, notwithstanding that a lot purchaser may have paid for a fully serviced lot. This result may be politically unpalatable, even if legally authorized. Secondly, the Court surmises that the municipality could impose a local improvement tax on the lots for unfinished improvements. The imposition of a local improvement charge would of course depend upon the willingness of the lot owners to accept that local improvement charge. A petition against a local improvement could frustrate this strategy (s. 396 MGA). Additionally, the municipality could seek to enforce the Development Agreement against each property owner who has acquired the lot subject to a caveat, but the result of such enforcement procedure is unsettled. And finally, and perhaps most importantly, the municipality may enter upon the land and take any action necessary to carry out the stop order (s. 646 MGA), and add the resulting expense to the tax roll (s. 553(7)(h.1) MGA). It is not clear whose tax roll or what tax rolls would be vulnerable to receiving such charges and who is to receive the benefit of other security provided by the Developer. Basically this mechanism works effectively if the costs are added to the lands of the developer before subdivision. The work required is all located upon public lands. Could lots with caveats only be saddled with the costs of completing the construction of the improvements or only to those to whom the stop order was properly issued?

It is difficult in circumstances where caveats are registered in respect of subdivision, or where servicing remains to be completed, to properly advise a lot purchaser that it should enter into an agreement and pay for the lot. From the developer's perspective, without presales, it is not possible for most to get financing. With no presales - no financing and no servicing is the result. Major developers gain a significant advantage as they may have resources to secure the financing for the costs of construction other than the lots to be created by the subdivision. Smaller developers will not likely have this luxury.

Home builders and lot purchasers have for the past 40 years relied upon the municipality to sufficiently secure performance under the Development Agreement, and as a general rule have not been concerned with potential impacts of the caveat. It has simply served as notice that the developer from whom they bought the lot is servicing the land. It cannot have been intended that a lot purchaser would assume any of the responsibilities that exist under the Development Agreement not specific to its lot and within its control.

The issuance of the stop order against the purchaser of a lot is an anomaly. The purchaser is not sure what he is to stop or what he is to do. He does not in most circumstances have the capacity, nor the legal entitlement, to do what is required to remedy the stop order and yet remains subject to that order. The stop order certainly appears to blight the Certificate of Title for the lands that he acquired notwithstanding that there is nothing wrong with the lot that he purchased. Any deficiencies typically exist within public lands or on public rights of way where the lot purchaser has no entitlement to perform the work in the first place. Moreover, what responsibilities fall to the lot owner are unclear. Basically, the effect of the stop order will be to bring to an abrupt halt any potential development of his lot and a significant devaluation of his property while some third party thought to be in default satisfies the party who alleges the default. If the developer is insolvent, that wait could go on for some period of time. Did the legislature intend this result?

For the most part, it is likely that lot purchasers will treat the caveat in the manner in which they have treated it for the past 40 years and assume the risk of compliance. There may be additional investigation to determine the nature of the developer and the extent of the security granted, however, this information as indicated may not be readily available. If at all possible, it would be useful to get an Estoppel Certificate from the municipality confirming that they have no intention of pursuing any remedies against the individual lot purchasers of the developer or subsequent purchasers.

Financial institutions

Financial institutions will likely not be prepared to assume the risk that municipal charges that have not been properly identified and disclosed would have priority over the security registered in favour of the bank. As a consequence, most lenders should require municipalities to provide notice of default and a standstill agreement for some period of time, absent risk of public harm. Moreover, lenders will likely require a postponement of any rights of the municipalities to the rights of the lender except perhaps in respect to the actual cost, including soft costs, of performing the work and any levies or other costs legitimately imposed. Lenders will have no appetite to remain in second place behind any costs recoveries which are not specifically and legitimately imposed upon the developer as authorized by the MGA. Part of the security required for servicing loans will include standstill arrangements and postponements the terms of which remain to be resolved.

Municipalities

Municipalities will be positively affected by the Focaccia decision to the extent that it enables them to compel timely adherence to their interpretation the contract and puts beyond doubt any debate about whether or not the developer’s interpretation or municipality’s interpretation of the engineering drawings and/or the Development Agreement is to be preferred. Municipalities, however, now will receive endless requests for information for each property which is the subject of a Development Agreement caveat as to the status, as to the security and as to the state of completeness of the municipal infrastructure. They will be requested to discharge the caveat and to provide estoppel certificates and/or other assurances that they have no intention of proceeding against the lot owner. Most municipalities do not have this information readily available and to receive an endless stream of requests for this information will become problematic. There may not be any means of compelling the municipality to disclose this information which means lot sales could come to a standstill or the purchaser of a lot will be required to depend solely upon the covenant of the developer with whom they are dealing. Effectively, this could eliminate a significant number of potential developers from being in a position to sell lots or develop lands resulting in fewer developers owning more of the land and a less competitive marketplace.

Municipalities will also now be required to engage with counsel for the lenders who are not prepared to advance funds while in second place, absent a strict contractual relationship between them governing priorities and the

conditions and terms upon which municipalities and lenders can concurrently proceed. Municipalities must appreciate they were getting municipal infrastructure at no cost to the municipality financed by these lenders and that can only continue if the lenders are satisfied that their loans are secure and reasonableness prevails in the application or enforcement of the Development Agreement. Lending institutions will also now carefully review the development or servicing agreement before advancing funds to fulfil servicing obligations contained in Development Agreements and will likely impose conditions on the borrowers to limit the priority and relief of the municipality.

Managing stop order

The developer must now be aware that both its prospective purchasers' and the lenders' concerns in relation to completion of the servicing have taken on significantly greater meaning. It is now incumbent upon the developer in execution of the Development Agreement to ensure that the municipality is bound to provide such accommodation to lot purchasers and lenders as they may reasonably require. The municipality may incorporate provisions in the Development Agreement that it will forego the issuance of a stop order and will postpone the caveat to financing in favour of the lender servicing the loan, and indeed discharge the caveat upon registration of the title in the name of a lot purchaser. Developers must be far more proactive in arranging the downstream impacts of the Focaccia decision and the potential for a stop order than they have to date.

Whether or not the sky has fallen or is falling, only time will tell.

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