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An overview of due diligence for land development

Not too many months ago, we were in the midst of the "Great Shutdown." On the industrial and residential real estate development front, it was so quiet you could hear crickets chirping outside. I went in one day to my office (narrowly avoiding a ticket, zooming through the "speed trap" that is now Interstate 25 at 8 a.m. on a weekday morning) only to see a couple of lonesome tumbleweeds rolling down the hall. Around this time, I wrote an article in this same publication discussing how the vesting (or preserving) of entitlements and zoning approvals operates in Colorado. I had thought this to be a timely topic as everything abruptly halted without any sense of when things would return to normal again.

Little did anyone know at the moment that the Colorado development environment, at least in the homebuilding and industrial sectors, was about to turn back around to business as usual, on a dime. These sectors quickly bounced back not in spite of the pandemic, but because of it.

It's not hard to come up with explanations. With one's residence instantly converting into an office, class room, quarantine facility and day care center all at once, the desire for one's own space had never been more acute. Homebuilders, who like everyone else had immediately pressed pause in early spring, recommenced land acquisition in earnest.

With no one leaving their homes, experienced online shoppers placed orders with reckless abandon and other consumers discovered that just about anything was available online for order and home delivery. The result was an immediate stress on existing logistics centers and the need to build more.

Cut to the present, and one unanticipated result of the pandemic is the continued need for raw land. As some short-term investment focus shifts to unimproved dirt, it's important to keep in mind that the feasibility process for raw land is markedly different than the process for improved assets. This article provides a general introduction to conducting due diligence investigations during the land development process, with a particular focus on evaluating the condition of a target property's soils, title and minerals.

■ **Do the dirty work.** It's no secret that the feasibility process will entail vigorous investigation

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of the physical aspects of the property. One of the most consequential studies will be a soils report. The condition of the soil may have impactful financial implications on a project. If the property has expansive soils (which expand and contract depending on moisture content), a common Colorado condition, the soils engineer may recommend sub-excavating the site, a process that entails digging up the site to introduce additional fill material that is then re-compacted with existing fill material. Sub-excavation will mean more heavy equipment work and will require first removing existing dirt before introducing new dirt. The additional construction work will add cost to the budget, and the developer also may have to identify a source for the new dirt. If the properties adjacent to the site are vacant, those owners may be amenable to letting the developer "borrow" dirt, but that's more of a term of art, as the developer will not return anything once the project is complete. The irony here is that in construction parlance, the phrase "dirt cheap" doesn't make sense. If dirt goes for $4 per cubic yard, for example, and hundreds of thousands of cubic yards are needed, there's nothing cheap about it!

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■ **The title commitment as development guide.** For some, reading title work is as exciting as going to the dentist. Title work can be about as dry as it gets, but the title commitment (and documents and instruments listed as exceptions on Schedule B-2) for your subject property often will be a treasure trove of information and provide a synopsis of the entitlement and development history of your property.

Annexation agreements, for example, which contain the terms and conditions of a property being included into a municipality and being entitled to the services of such municipality, usually will be of record. Don't assume every annexation agreement is the same, or just a boilerplate agreement. To the contrary, the annexation agreement for your property may have certain payment, dedication or development obligations that are triggered upon, say, pulling the 100th permit in a residential subdivision. If there is no annexation agreement of record and the property has not been annexed into any municipality, this is essential to know as well.

If your seller or predecessor in interest has pursued specific zoning for your property, often the zoning ordinance specifying the zoning for your property (i.e., planned unit development) will be of record. If your predecessor subdivided the property, the plat and subdivision improvement or development agreement also will be of record, and these documents will be essential reading. Again, don't assume your development agreement is a standard form agreement. On the other hand, it's better to anticipate, and look for, project specific terms and conditions. It doesn't mean that they'll be there, but you can't really afford to miss them.

When reviewing your title work, be wary of any obligations in any instruments that may run with the land. By virtue of title vesting in you or your entity, you, as the owner, become responsible for such obligations (Lookout Mtn. Paradise Hills v. Viewpoint, 867 P.2d 70, 73 (Colo. App. 1993)). It's not unusual to uncover a cost-sharing agreement burdening an unimproved parcel with reimbursement obligations for infrastructure constructed by an adjacent property owner. A prudent buyer will want to contractually obligate its seller to extinguish such obligations or, at the very least, budget for the cost of paying off the neighboring owner.

The tax certificate for the property also is important to review at the inception of the feasibility process. Often the tax certificate is only reviewed in the context of closing the deal, to determine the amount of any unpaid taxes and to prorate the tax liability between the parties. However, the tax certificate represents an important investigatory tool. The tax certificate will identify those various governmental authorities levying taxes and assessments (some of which may be able to issue bonds and impose mill levies on the property for the bonds' debt service). The tax certificate also will identify the classification of the property and whether it carries an agricultural classification (which results in a lower assessed value) that, where possible, may be advantageous to maintain before development begins.

■ **The mineral estate may be disconnected from the surface estate.** Another useful item contained in your title commitment will be the initial or first severance of the mineral estate from the surface estate of one's property – to the extent this has occurred. Your title commitment will not contain a chain of title for minerals, but there may be enough of record for you to piece together the current condition of the mineral estate to your property. Identifying third parties that may own or lease the mineral rights to the subject property, when the mineral estate has been severed from the surface estate, is another essential part of any due diligence investigation. If your minerals have been severed, the mineral rights holders will have the right to use the surface of your property for extraction and operations (Gerrity Oil and Gas Corp. v. Magness, 946 P.2d 913, 926 (Colo. 1997)) absent a waiver of or contractual agreement to modify such surface rights, subject to any applicable local government and Colorado Oil and Gas Conservation Commission Regulations.

The Colorado surface development notification statute (C.R.S. § 24-65.5-101 et seq.) is in place to help address the ongoing tension and literal priority of place between mineral estate owners (who have surface rights) and surface estate owners (who want to develop the surface of their property). The statute requires the surface owner to search the assessor's records to identify the current mineral rights owners or holders and to give them notification that the surface may be developed in the near term.

The obligation to deliver such notification is triggered by an "application for development" (C.R.S. § 24-65.5-102(2)), which is broadly defined as an "initial application" for a variety of entitlements or for zoning or rezoning. Once the notifications go out, the statute requires mineral estate owners to respond if they have any objection to the proposed surface estate development and, if so, to confer with the surface estate owners to reconcile both parties' respective concerns regarding surface access for oil and gas operations and surface development (C.R.S. § 24-65.5-103.3).

As such, it's not unusual to uncover during title review a surface use agreement where the mineral estate owner has agreed with the surface estate owner to limit oil and gas operations areas to specific areas of the property. Alternatively, some mineral estate owners may have agreed to relinquish surface use and access altogether. A prudent buyer will be familiar with the minerals situation for a target property and have confidence that any mineral rights holders have been sufficiently corralled off site or to a portion of the target property where oil and gas operations won't interfere with surface development, use and enjoyment.

■ **We're only scratching the surface.** During the due diligence process for land acquisition, it is necessary to obtain a soils report, carefully review the condition of title to the subject property, and to identify which third parties may own or lease the mineral rights to the subject property, and if those parties have corresponding surface use or access rights. This is by no means an exhaustive list of issues or a concise due diligence checklist, but more of a brief introduction into the myriad issues one can expect while undertaking due diligence and feasibility investigation for a land development deal (such as restrictive covenants, ditches and canals, blanket easements or, conversely, utility lines or flow lines crossing a property without the benefit of an easement). In short, when commencing your due diligence process, and as with the last eight months, be ready for anything and expect the unexpected.

Scott Ross and Will Soper of Fox Rothschild LLP contributed to this article. ▲