

TRENDS IN REAL ESTATE AND TITLE INSURANCE

Zoning **Due Diligence** In New Jersey

Development restrictions, even those not of record, may be enforceable against bona fide purchasers.

BY HOWARD D. GENESLAW

REAL ESTATE lawyers in New York, who do not counsel their clients to perform a zoning and permitting due diligence investigation before acquiring or investing in real property located in New York, should be aware that a purchaser has such an obligation in New Jersey. Unlike in New York, where the purchaser generally is bound by restrictions only if they are of record, in New Jersey, a development restriction that is not of record may nevertheless be enforceable against a bona fide purchaser who has no knowledge of it. Thus, it is incumbent upon those purchasing and investing in New Jersey property to perform a thorough zoning and permitting due diligence investigation before proceeding with the transaction.

Suppose a purchaser acquires property in New York, unaware of a prior application to the local planning board by a predecessor in title which resulted in a restriction against further subdivision of the property. The purchaser, now owner, files an application for subdivision approval, which is denied due to the prior development restriction. Is the restriction binding?

In *Buffalo Academy of the Sacred Heart v. Boehm Bros.*, 267 N.Y. 242 (1935), the Court of Appeals held that a restriction must appear in the chain of title in order to be binding. In later decisions, the Court of Appeals made clear that purchasers need not search outside the chain of title, at least in circumstances where a grantor-grantee indexing system is used. *Witter v. Taggart*, 573 N.Y.S.2d 146 (1991); *Andy Associates v. Bankers Trust Company*, 424 N.Y.S.2d 139 (1979).

In reliance on this authority, the Appellate Division, Second Department, when presented with the foregoing facts, ruled last year that the purchaser is not bound by the restriction since it was filed only in the planning board's records and not in the chain of title. Thus, purchasers of property in New York, at least where a grantor-grantee indexing system is used, have no affirmative obligation to search outside the chain of title for restrictions on development that may have been imposed as a condition of development approvals.

New Jersey Rule

The rule in New Jersey is exactly the opposite. In *Aldrich v. Schwartz*, 258 N.J. Super. 300 (App.

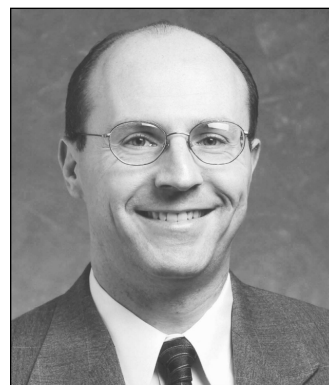
Howard D. Geneslaw is a director at Gibbons, Del Deo, Dolan, Griffinger & Vecchione, in the firm's New York and Newark, N.J., offices.

Div. 1992), the court held that a development restriction, upon which a variance had been conditioned some two decades earlier, was enforceable against subsequent owners even though they had no knowledge of it, irrespective of whether a reasonable search would have identified it. To understand the far-reaching import of this decision, it is critical to appreciate its context.

Aldrich involved a three-lot minor subdivision of oceanfront property in 1969. The zoning ordinance in effect at the time required that a 20-foot easement be granted across each of the three lots in order to provide access between the public street and the ocean. Since an existing residential dwelling prevented the grant of the full 20-foot easement across one of the proposed lots, the zoning board of adjustment granted a variance to allow deviation to 15 feet. As a condition of approval, the board of adjustment restricted a portion of the oceanfront lot against future development. The lots were sold and houses were built, in conformity with the development restriction.

About 20 years later, after several conveyances of the oceanfront lot, John F. Aldrich purchased it with the expectation of demolishing the existing home and building a new one. The municipality stymied this plan by refusing to issue development permits based on the development restriction.

The restriction itself appeared in the board of adjustment resolution and on the subdivision plat. New Jersey law currently permits (and apparently did so at the time in question) minor subdivisions to be recorded by deed or by plat. In this instance, no plat was ever recorded, so apparently the subdivision was created by deed. Although the court's opinion indicates a deed reference to the prior subdivision, the deed itself does not recite the development restriction. New



Howard D. Geneslaw

Jersey law does not require the recording of resolutions of approval issued by planning boards and zoning boards of adjustment, and the practice (particularly before *Aldrich*) was rare. Thus, the restriction was not of record.

Mr. Aldrich did not consult the municipality's records before completing the conveyance. Had he done so, he would have learned of the restriction and could have acted accordingly. The *Aldrich* court explained its ruling as follows: "If subsequent owners are entitled to the benefits of the variance and the value it adds to the property, even though they are unaware of its existence, they should enjoy those benefits limited by any restrictions which were lawfully attached as conditions, subject to current zoning agency relief." Id. at 308-09.

The court went on to explain that Mr. Aldrich had three options: seek relief from the variance conditions, seek judicial invalidation of the restriction, or apply for a variance seeking "cancellation" of the variance. The first and third options on their face appear to be essentially the same, and the second option raises significant issues regarding the statute of limitations. In any event, Mr. Aldrich clearly did not get what he bargained for.

In a subsequent action by Mr. Aldrich against the title company, the municipality and various predecessors in title for damages accruing from the development restriction, the Appellate Division further established a prospective purchaser's obligation by explaining that "[t]he police power exclusion in the [title] policy squarely places on the prospective purchaser and his attorney the burden of investigation and compliance with

local ordinances and land use resolutions as they may affect a particular property." *Aldrich v. Hawrylo*, 281 N.J. Super. 201 (App. Div. 1995).

The New Jersey Supreme Court has since distinguished *Aldrich v. Schwartz* by finding that an error involving a New Jersey Department of Environmental Protection development restriction, whereby the recorded instrument did not clearly express the geographic extent of the restriction, was not binding on a subsequent purchaser. *Island Venture Associates v. New Jersey Department of Environmental Protection*, 179 N.J. 485 (2004). The Court commented that the agency was in the superior position to be aware of the restriction, and that it erroneously advised the original owner that the restriction did not apply to the portion of property in question.

The purchaser's obligation to undertake a due diligence investigation when acquiring real property in New Jersey remains a significant aspect of the steps associated with property acquisition. It is on the same plane as the title review, mortgage contingency and physical inspection.

Scope of Investigation

A zoning and permitting due diligence investigation can reveal many things that would be of interest to a prospective purchaser. These are some examples, based on transactions in the author's practice:

- In the acquisition by an investor of a significant interest in a shopping mall, a review of numerous resolutions of site plan and variance approval over several decades disclosed that the number of parking spaces in existence was somewhat less than what was approved by a series of variances, and that an outparcel was zoned so as not to permit the appropriate use.

- In the acquisition of a multi-million-square-foot office complex, significant portions of which were approved but not built, a review of the resolutions of approval indicated that the municipality in question followed an approval process not authorized by statute, resulting in the potential invalidity of the approvals themselves. Without those approvals, the value of the property would have been significantly lower.

- In the acquisition of an apartment building,

review of prior approvals disclosed that a subsequent plan amendment had not been the subject of public notice even though the initial approval expressly required public notice.

- In the acquisition of a freestanding commercial building, a review of municipal records disclosed a prior subdivision which was improperly perfected, raising questions relative to the validity of the subdivision itself and the subsequent conveyance of one of the subdivided lots.

In each of these instances, identification of one or more potentially significant issues called into question the validity of the approvals or the legality of the existing development. The prospective purchaser was then able to raise the issues with the seller and use them either to strengthen its negotiating position with respect to other issues on the table, or to achieve a reduction in the purchase price. In virtually every instance, the issues identified more than pay for

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the cost of the investigation. They may also avoid litigation later and avoid an unhappy post-closing surprise.

A zoning and permitting due diligence investigation should not be limited to a document review, but should also involve interviews with municipal, and perhaps county and state, officials. Although the seller may provide much of the relevant documentation, a public records search is

also essential to ensure that the purchaser has as complete a picture as possible of the asset under consideration.

Depending on what the documents reveal, further actions may be warranted. For example, if a condition of approval is identified that poses problems for the purchaser, an application to the appropriate authority for relief from the condition may be appropriate, particularly if there has been a change in circumstances since the condition was first imposed. If the investigation reveals that the existing use is nonconforming, the purchaser may wish to obtain, or to require that the seller obtain, a certificate of nonconforming use to evidence the municipality's acknowledgement of its legal status.

Another issue worth investigation is whether any of the tax lots in question are undersized pursuant to the municipal zoning ordinance and, if so, whether the municipality could have claimed that a lot merger has occurred. Under New Jersey law, adjacent undersized parcels not in common ownership can be deemed to have merged for zoning purposes if they have been engaged in a common use. Once that has occurred, they cannot be separately developed, or possibly even conveyed, without obtaining subdivision approval.

Finally, unlike in New York, title reports in New Jersey do not include a violations search. Thus, any zoning and permitting due diligence investigation should include inquiries of the local health, fire, construction and zoning officials, as well as the municipal court, to determine whether any violations are pending or whether there is a history of violations.

Conducting a thorough zoning and permitting due diligence investigation precedent to the purchase of real property in New Jersey not only satisfies a legal obligation, but it educates the purchaser in a way that will allow for more informed negotiations and reduce the overall risk of the transaction.

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GIBBONS

GIBBONS, DEL DEO, DOLAN, GRIFFINGER & VECCHIONE

A PROFESSIONAL CORPORATION

ATTORNEYS AT LAW

One Riverfront Plaza
Newark, New Jersey 07102
973-596-4500 • Fax: 973-596-0545

One Pennsylvania Plaza
New York, New York 10119
212-649-4700 • Fax: 212-333-5980

The Lutine House
224 West State Street, Suite 1
Trenton, New Jersey 08608
609-394-5300 • Fax: 609-394-5301

www.gibbonslaw.com