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Short-Term Rental Regulations after Schroeder

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The North Carolina Court of Appeals ruled in *Schroeder v. City of Wilmington* that state law prohibits a registration requirement for short-term rentals, but the court also ruled that state law allows for general zoning and development standards for short-term rentals. What does that mean for specific local ordinances, exactly? As always, the devil is in the details. This blog digs into those details.

The Wilmington Ordinance

The City of Wilmington adopted an ordinance regulating short-term rentals. Among other things the ordinance established a 400-foot separation between short-term rentals and set a cap on the total number of short-term rentals (two percent of residential properties). In order to enforce the new

ordinance the city required registration of short-term rentals and held a lottery for the initial registration. The ordinance had a one-year amortization period for existing operators to cease operations if they were not awarded a registration through the lottery process.

Beyond the registration requirements, the ordinance included operational and safety requirements for any short-term rental. The ordinance limited short-term rentals to certain zoning districts, required safety information to be posted in the rental unit (nonemergency police number and days for trash pick-up), prohibited cooking in bedrooms, and required parking.

The plaintiffs operated a short-term rental prior to the ordinance, did not obtain a permit through the initial lottery, and challenged the ordinance on statutory and constitutional grounds.

Statutory Limits on IPR Programs

A central issue for the challenge was this: What is the scope of the statutory limits of permits, permissions, and registrations for rental residential property? Does state law preempt the registration program and other elements of the Wilmington short-term rental ordinance? The answer to this question depends on the interpretation of the state law relating to housing code inspections, permits, and registration (IPR) programs.

Dating back to 2011 the North Carolina General Assembly established and revised limits on local government IPR programs. Originally codified at G.S. 160A-424 and G.S. 153A-364, these statutes prohibit periodic inspections of residential rental properties except for certain limited situations. The statutes also limit fees, permits, and registration requirements for residential rental properties. The details of IPR programs and the statutory limits are discussed more fully in this bulletin from Tyler Mulligan on Residential Rental Property Inspections, Permits, and Registration: Changes for 2017.

In 2019 the General Assembly amended G.S. 42A-3 to make clear that the limits on IPR programs *do apply* to properties subject to the Vacation Rental Act. Many (perhaps all) short-term rental properties fall under the Vacation Rental Act, so that legislation applied the statutory limits on IPR programs to short-term rentals. That legislative change is discussed more fully on page 14 of this legislative bulletin. The initial legislation for IPR programs was focused on conventional landlord-tenant housing scenarios and related to habitability, problem properties, and inspections authority. Some of the current interpretative challenges arise from applying a statute written for one scenario—rental for long-term residential use—to a different scenario—rental of a residential structure for transient occupancy.

Additionally, in 2019, the General Assembly adopted Session Law 2019-111 to revise and update the statutes relating to local planning and development. The old statutes were collected as a new Chapter 160D. The provisions on IPR programs were relocated to G.S. 160D-1207. That section was situated in

Article 12 – Minimum Housing Codes. The statutory language was amended to emphasize the relation to Article 11 – Building Code Enforcement and Article 12 – Minimum Housing Codes.

The key statutory language now states that local governments may not "require any owner or manager of rental property to obtain any permit or permission under Article 11 or Article 12 . . . to lease or rent residential real property or to register rental property with the local government."

Court Decision

With that statutory context and legislative history as backdrop, property owners brought a legal challenge against the Wilmington short-term rental ordinance. The central question that the courts addressed is the question of the scope of the limits for IPR programs. With regard to short-term rental ordinances, does the statute preempt local governments from imposing a registration requirement? Or permit requirement? Or any restriction at all?

The Superior Court ruled that the statutes prohibited Wilmington's registration requirement for short-term rentals. The court struck down not just the registration requirement, but the entire short-term rental ordinance.

The North Carolina Court of Appeals took up the case in *Schroeder v. City of Wilmington*, 2022 NCCOA 210 (COA21-192). As discussed more below, the court interpreted the limits on permits to apply narrowly to permits *under Article 11 or Article 12 to lease or rent residential property*. The court interpreted the limit on registration to be broadly applicable—not limited to housing code or building code enforcement. With that, the court affirmed the trial court's decision that the registration provisions were invalid under G.S. 160D-1207(c). The court struck down the registration requirement and the provisions inextricably linked to the registration requirement, but notably the court allowed the other provisions of the Wilmington ordinance to stand.

The analysis and discussion in the Court of Appeals' opinion offers guidance and highlights questions for moving forward with short-term rental regulations, IPR programs in general, and interpretation of Chapter 160D. This blog is focused on short-term rental regulations.

Moving Forward with Short-Term Rental Regulations

No Rental Registration

The court plainly struck down the registration program of the Wilmington short-term rental ordinance as preempted by G.S. 160D-1207(c). Moreover, the court struck down other "provisions of the Ordinance [that] are so intertwined with the invalid registration requirement that they are likewise

preempted by Section 160D-1207(c)." These include the cap and distance requirements, proof of shared parking prior to registration, the registration termination provisions, posting registration numbers in the rental unit, and the amortization of rentals without a registration.

It is worth noting that G.S. 160D-1207 does allow for registration requirements for residential rental property in very limited circumstances based on prior violations. That exception was not part of the Wilmington ordinance nor at issue in the *Schroeder* case.

Regulations Unrelated to Registration Remain

The Court of Appeals did not strike down *all* regulations for short-term rentals. Rather, the court affirmed that many of the Wilmington requirements are unaffected by preemption. The court quoted *Fulton Corp. v. Faulkner*, 345 N.C. 419, 422, 481 S.E.2d 8, 9 (1997), and gives effect to the ordinance's own severance clause to allow non-offending provisions to remain: "We will give effect to this [severance] clause to preserve any provisions that are 'not so interrelated or mutually dependent' on the invalid registration requirements that their enforcement 'could not be done without reference to the offending part.'"

The court identified the following ordinance provisions as preserved (not preempted): Restricting whole-house lodging to certain zoning districts; parking requirements (one off-street space per bedroom); prohibition on variances; operation limits and requirements (no large events, maintain insurance, manage trash, no food prep in bedrooms); posted safety information; and other use and safety requirements not preempted.

Even some of the provisions stuck down in *Schroeder* might be authorized and enforceable without the registration program to taint the provision. For example, the requirement to show proof of shared parking prior to registration was struck down, but the general requirement for parking survives.

Similarly, in this particular case the court struck down amortization related to registration, but arguably an amortization provision related to standard zoning enforcement (unrelated to registration) could survive.

In general, local governments have authority to define land uses, set reasonable development standards and limits on those land uses, and require some level of permitting for such land uses. The following sections consider the breadth of authority for development regulations for short-term rentals in light of the *Schroeder* case.

Define Short Term Rental as a Land Use

Local zoning ordinances commonly define land uses and set restrictions on those uses. An ordinance might define and limit several types of land uses that can occur in a residential structure, including single-family dwelling, boarding house, bed-and-breakfast, duplex, and professional office, among others. The local government can define those land uses and regulate where those land uses are permitted.

The *Schroeder* case clearly affirms the local authority to add short-term rental to that list of land uses. The Wilmington ordinance identified "whole-house lodging" as a land use and limited that land use to certain zoning districts. The court explicitly upheld that regulation.

Apply Development Standards and Operational Limits

Local ordinances commonly set restrictions and limitations on development. These may include parking requirements, solid waste management, occupancy limits, operational restrictions, and more. The *Schroeder* case affirms several development standards of the Wilmington short-term rental ordinance, including parking requirements, limits on large events, trash management, insurance requirements, safety requirements, and other development limits. Under the general authority for development regulations and police power ordinances, similar development standards may be applied to short-term rental uses as long as they are not tied to an impermissible rental registration program.

Require Development Approvals for Short-Term Rentals

Based on the *Schroeder* case, a local government may not require a short-term rental operator to register with the local government and the local government may not require a permit or permission under the building code or housing code to rent or lease property. But, may the local ordinance require the operator to obtain some other development approval such as a zoning compliance permit for the

land use? Short answer: Based on the case and the statutory authority, an ordinance could require a zoning permit or similar development approval, but an ordinance could not use a zoning permit in a way that amounts to a registration program.

The court responded directly to the concern that this case might impact the scope of zoning or other permitting authority. In Footnote 8 the court stated:

> We do not interpret Sections 160A-424(c) or 160D-1207(c) as exempting rental properties from all zoning or permitting requirements; as Plaintiffs conceded at oral argument, even their reading would not preclude Wilmington from zoning or requiring Plaintiffs to obtain a building permit to construct an addition to their property. Our reading does not prohibit these actions either and only limits "permit[s] . . . *under Article 11 or Article 12 . . . to lease or rent.*" N.C. Gen. Stat. § 160D-1207(c)

(emphasis in court opinion).

Zoning compliance permits, special use permits, site plan approval, and other development approvals are foundational to zoning administration and enforcement. If a property owner wants to convert a grand old residence to a bed-and-breakfast, such a change of use likely triggers the need for development approvals and other permits. Similarly, under most ordinances an owner of a residential structure must obtain certain development approvals in order open a home daycare facility, operate a business out of the residence as a home occupation, or rent rooms as a boarding house. Such ordinances commonly require a basic site plan, limit the number of outside employees, restrict parking, and impose other restrictions.

The authority for these permits is outlined in Chapter 160D. As required at G.S. 160D-403, "no person shall commence or proceed with development without first securing any required development approval from the local government . . . ." The term *development approval* is defined at G.S. 160D-102 to mean "[a]n administrative or quasi-judicial approval made pursuant to this Chapter that is written and that is required prior to commencing development or *undertaking a specific activity*, project, or development proposal. Development approvals include, but are not limited to, zoning permits, site plan approvals, special use permits, variances, and certificates of appropriateness" (emphasis added). For

local government staff charged with administering development regulations, the duties that may be assigned include "determining whether applications for development approvals meet applicable standards as established by law and local ordinance" (G.S. 160D-402).

Based on the case language and the statutory authority, local governments may require an owner to obtain a development approval such as a zoning compliance permit as a requirement of a short-term rental land use.

What is the line between a permissible zoning compliance permit and an impermissible registration requirement? The court plainly drew a difference between a permit requirement and a registration requirement. The court expressly rejected the argument made by the property owners that a bar on registration is a bar on *any* permitting scheme. But the court also, in Footnote 9 of the case, left open the possibility that an ordinance could be struck down if a permit requirement was merely a registration requirement in disguise. Such an ordinance "would be open to legal challenges asserting that the statute's language should be applied to reach any 'permit' that is, in all practical effect, a registration otherwise barred by the statute."

The determination of *permit vs. registration* will be a fact-specific inquiry, dependent upon the details of the particular ordinance and the paperwork requirements. In general, registration programs involve an owner or operator submitting basic information about the rental property (such as property address, owner name, 24-hour contact, etc.). Development approvals, on the other hand, commonly involve an application form with information to confirm compliance with applicable standards.

The regularity of submitting paperwork (requiring an annual permit, for example) may be instructive, but is not determinative as to whether it is a permit or registration. While most development approvals are focused on initial construction and commencement of a land use, there are examples of land uses that must seek development approvals more regularly. G.S. 160D-403(c) specifically allows that "[l]ocal development regulations may provide for development approvals of shorter duration for temporary land uses, special events, temporary signs, and similar development." Development

ordinances commonly require seasonal land uses such as Christmas tree lots and pumpkin sales to seek a zoning permit each year. Some ordinances require an annual zoning permit for properties that host food trucks.

Arguably, a short-term rental ordinance could require operators to seek permits with some regularity, but as noted by the court, if the permit is "in all practical effect, a registration otherwise barred by the statute," then the requirement is likely to be preempted.

Use Separation and Development Caps

The requirement that a land use must be a certain distance from other land uses is a fairly common requirement in local development regulations. Under the applicable statutory rules, family care homes may be separated by up to one-half mile. Ordinances commonly require that adult businesses must be separated from each other and from schools and churches. Restrictions may limit how close bars can be to each other. Under local development regulations certain industrial land uses must have a buffer from residential land uses.

This commonplace zoning regulation is rooted in the grant of power set forth at G.S. 160D-702: "a zoning regulation may regulate and restrict . . . the location and use of buildings, structures, and land." Despite this context, the Court of Appeals struck down the Wilmington ordinance separation requirement. Notably, though, the court struck the separation requirement as "so intertwined with the invalid registration requirement that [it is] likewise preempted by Section 160D-1207(c)." There is a good argument that a basic separation requirement enforced through a standard zoning permit could stand even though the Wilmington separation requirement (being dependent on the unauthorized registration program) was preempted.

The general idea of a cap on a particular use is interesting. While it is not commonplace for a zoning ordinance to set a percentage cap on a particular use directly, zoning establishes caps on development in many ways. Indeed, zoning is all about caps—the basic zoning authority allows for regulating and limiting land uses. Certain zoning districts allow residential uses (residential development is capped and limited to those districts), and other zoning districts allow for industrial uses (industrial development is capped and limited to those districts). Density limits set caps on the number of units in a development or in an area. Mixed-use standards may require a certain mix of land uses, thereby

capping some uses within the development. Moreover, the separation requirements discussed above have a capping effect because the separation limits the locations where a particular use may be permitted.

A cap on a land use may also arise in another context: there can be a cap on the amount of a land use in a particular development or building. Imagine a homeowner who operates a professional business out of a home office. If the office use is secondary to the residential use it may be permitted as an accessory home occupation. But, if the office use fills most or all of the residence—all bedrooms are converted to offices and the living room is a conference room—then the building is no longer used principally as a residence. Different zoning rules and permitting likely apply to the office land use. Similarly, consider a condominium high-rise building. If a few units are occasionally rented as a short-term rental, that may not dramatically change the nature of the land use. But, if all units are rented as short-term rentals, that building is effectively a hotel. Different zoning rules and permitting likely apply.

The Wilmington ordinance included a general cap on the percentage of properties that may be used as short-term rentals. The court struck down that cap along with the registration program. Going forward it is clear that an ordinance may not impose a cap through a registration program. Arguably, a cap could be established and enforced through conventional zoning requirements.

Conclusion

Based on state law and the *Schroeder* case, a local government may not impose a registration requirement on short-term rental operators. Moreover, regulations and standards that are inextricably linked to a registration requirement may be struck down. But, local governments still have authority to regulate short-term rentals through common development regulations and police power ordinances focused on public health and safety.