



“Ruckus” goes to Austin, Texas to visit with Legislators

## **WHAT IS ALL THE “RUCKUS” ABOUT THESE SHORT-TERM RENTALS: I OWN THE PROPERTY?** **By: Leslie Spear Schmidt, Senior Assistant City Attorney, City of Amarillo**

### **I. INTRODUCTION**

As internet use has become commonplace in most United States households, a “sharing economy,” in which private individuals rent assets or services to others, either for free or for a fee, is a cultural revolution in the way individuals shop for and rent cars, homes, bedrooms, tools, specialty equipment, and other individually owned assets or services from others. One example of such rental or service is in the short-term rental of a room or an entire private home. Airbnb, founded in 2008, is seeing exponential growth as it provides a marketplace for accommodations in more than five million locations within 81,000 cities and 191 countries.<sup>1</sup> Other sites providing similar short-term rental services include Vacation Rentals by Owner (VRBO), Home Away Rentals, and flipkey.com rental properties.<sup>2</sup> In some cases, short-term rentals can make as much as long-term rental income with a few short time period rentals. As a result, not only are short-term rentals lucrative to homeowners but also to investors.

The Airbnb began with a San Francisco startup, in 2008, by two roommates who offered space on air mattresses to aid in their rent payment. In some ways, this is similar to the Uber revolution transforming everyday vehicle owners into self-employed taxi drivers generating dollars for their services. Now, with web-based lodging sites, a traveler is brought together with a landlord in cyberspace and often avoids taxes and regulations. These armchair travelers can preview accommodations, room by room, and scrutinize comments and features.<sup>3</sup>

Since Airbnb’s startup, a new industry of peer-to-peer accommodation rentals have flourished to an estimated 79 million booked room nights in 2015 to a potential for bookings up to 1 billion room nights by 2025.<sup>4</sup> The marketplace for short-term rentals has exponentially developed over the last decade as multiple platforms now offer millions of short-term rentals all around the world, including:

**Vacation Rental by Owner (VRBO):** Founded in 1995 and a veteran of the online STR space, and this site has thousands of listings and is a part of **HomeAway**, which also owns **VacationRentals.com** and its luxury site, **Luxury.HomeAway.com**.<sup>5</sup>

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<sup>1</sup> <https://www.airbnb.com/about/about-us>

<sup>2</sup> <https://www.vrbo.com>; <https://www.homeaway.com>; <https://www.flipkey.com>

<sup>3</sup> “Airbnb: Innovation and Its Externalities,” *The Municipal Lawyer Magazine*, p. 6.

<sup>4</sup> Clay Dillow, “Can Airbnb Book a Billion Nights a Year By 2025?” *Fortune* (2016).

<sup>5</sup> Stephanie Rosenbloom, “Giving Airbnb a Run for Its Money,” *The New York Times* (2015).

**FlipKey:** Founded in 2007, FlipKey has over 300,000 properties and has since been acquired by TripAdvisor.<sup>6</sup>

**KidandCoe.com:** Founded in 2013, this site caters to families offering “kid-friendly rentals with children’s rooms and amenities.”<sup>7</sup>

**PreferredResidences.com:** Preferred Hotel Group started the site in 2015 for “those seeking luxury bungalow, villas and condominium rentals”.<sup>8</sup>

This “sharing economy” has been shaped by these different short-term rental places offering a digital marketplace where property owners can rent their home, guesthouse, or even a spare bedroom on a short-term basis. Homeowners many times reap a financial windfall from such rentals while cities deal with the potentially negative consequences related to allowing these rentals. In regulating short-term rentals, cities deal with a variety of issues ranging from collection of hotel occupancy taxes to noise complaints from neighbors. In Texas, there were few, if any, collections of hotel occupancy taxes or regulations for short-term rentals as this robust phenomenon began. Responding to this thriving economic demand, many cities are now considering whether to allow short-term rentals in their communities or not. These decisions can be controversial as homeowners, investors, and advocacy groups resist any regulations for short-term rentals in their communities. To the contrary, the hotel industry has voiced their concern that short-term rentals engage in unfair competition by not paying lodging taxes as well as not complying with local zoning and safety regulations.

## **II. WHY SHOULD MUNICIPALITIES EVEN “PLAY BALL”?**

### **A. HOTEL INDUSTRY CLAIMS “FOUL BALL”**

In June, 2015, the Federal Trade Commission brought together experts and stakeholders to consider the issues arising from the “sharing economy” phenomena.<sup>9</sup> As the Federal Trade Commission Report reflects, hotels and bed & breakfasts repeatedly have requested the state and local regulators to set standards applicable to all participants in this type of business to create a level playing field for all. The hotel representatives assert that everyone should “play by the same rules” to protect consumer safety, security, and the integrity of neighborhoods and communities. Moreover, they argue that the failure to enforce similar requirements erodes the regulatory goals and creates an unfair competitive advantage for hosts using Airbnb or similar platforms. Consequently, research of cities across the United States show “an uneven playing field” is created.<sup>10</sup> The short-term rental industry has not collected hotel occupancy taxes nor regulated this robust economic guest services industry.

Similar to the hotel industry claiming uneven treatment is the individual and corporate landlords, who discovered their supposed long-term tenants were making money by offering lodging to strangers. An example of such a situation was the battle that unfolded in June of 2014 as a New Yorker began eviction proceedings and sought recovery for unjust enrichment. Her tenant was re-renting her \$1,463 a month, rent-stabilized two bedroom apartment for \$250 a night.<sup>11</sup> Of course, landlords, especially large property owners, were concerned that this “sharing economy” created an uneven playing field for those with long-term tenants. They echoed the hotel industries’ concerns for similar standards on all comparable platforms.

In Texas, the 2015 Texas Legislature passed a law where the state and cities could collect hotel occupancy taxes for a short time period rental. However, the mechanism for tax collection proved difficult to enforce. The Texas

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<sup>6</sup> Id.

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> Federal Trade Commission Report, The “Sharing” Economy (November 2016) at 71 (citations omitted)(hereinafter “FTC Report”). In June 2015, the FTC brought together legal, economic and business experts as well as stakeholders to examine competition, consumer protection, and economic issues arising from the sharing economy activity.

<sup>10</sup> Id.

<sup>11</sup> Id.

Comptroller's Office entered into a tax agreement in 2017 for the home sharing platform to automatically collect a 6 percent tax from people who booked in Texas and remit the revenue directly to the State.<sup>12</sup> The cities, however, have been on their own to resolve this dilemma over these tax collections.

Moreover, just as hotels and beds and breakfasts are required to conform to city rules and regulations, such as building and fire codes, as well as those considered nuisances, cities grapple with not only those short-term rental regulations, but also, zoning restrictions, especially those with residential type characteristics. In Texas, zoning generally is restricted to land within a city's corporate limits, and this power to zone property is delegated from the state, which gives a municipality the exclusive authority to zone. The purpose of zoning, while never statutorily defined, is to promote "the public health, safety, morals, or general welfare" and protect and preserve "places and areas of historical, cultural, or architectural importance and significance."<sup>13</sup> Moreover, municipalities must zone in compliance with their comprehensive plan.<sup>14</sup> One of the components of such plan is for the distribution and relationships of various land uses that serve as the future basis for design to "(1) lessen congestion in the streets; (2) secure safety from fire, panic, and other dangers; (3) promote health and the general welfare; (4) provide adequate light and air; (5) prevent the overcrowding of land; (6) avoid undue concentration of population; or (7) facilitate the adequate provision of transportation, water, sewers, schools, parks, and other public requirements."<sup>15</sup> Within a City environment, a property owner possesses certain expectations of locating in a single-family residential neighborhood where the owner can enjoy at least a minimum atmosphere of a residential character not expected by travelers acquiring accommodations for a short time period with no expectation of investing in the integrity of the neighborhood.

## **B. RENTERS ALSO EXPERIENCE NOT ONLY "HOMERUNS" BUT "OUTS"**

Renters unquestionably benefit from an increased supply and variety of lodging. A host's residence may be cheaper than a hotel room as well as meet the renter's individual preferences regarding a neighborhood environment with few or no traditional hotels in the area. Airbnb reports the spillover benefits that result are such things as the availability of lower-priced offerings through Airbnb, travelers visiting cities more often and staying longer, and spending of cost-savings on restaurants and entertainment.<sup>16</sup> However, renters do find on occasion that their rental has been trashed or used for illegal activities. For instance, if people previously were able to buy drugs at this location, then some of those visitors may return requesting additional product, and if the renter is absent, the location and contents may be trashed. Insurance may cover such damage for a home or apartment that is trashed, but the use of such place for illegal activities is much more problematic. The renter then either must find alternative accommodations or rebook with another company for another date. Certainly, this inconvenience is nominal compared to the possibility that someone could believe that the renter is a part some way of the illicit activities within the home or apartment.

## **C. MUNICIPAL ISSUES WITH SHORT-TERM RENTAL "POP UP FLY BALLS"**

Why should municipalities even consider playing ball with short-term rentals and require the same regulations and standards as hotels and bed & breakfasts? After all, Airbnb describes their activities as not being commercial in

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<sup>12</sup> <https://comptroller.texas.gov/taxes/hotel/airbnb-faq.php> and <https://comptroller.texas.gov/taxes/hotel/homeaway-faq.php>.

<sup>13</sup> Texas Local Government Code Ann., Section 211.001 (Vernon's 2016).

<sup>14</sup> A comprehensive plan generally is defined as a long-range plan intended to direct the community's growth and physical development for an extended period of time. During this planning process, a community assesses what it has, what it wants, how to achieve what it wants, and finally, how to execute the plan. Texas Local Government Code Ann., Section 211.004 (Vernon's 2016).

<sup>15</sup> Id.

<sup>16</sup> FTC Report at 69-70 (citations omitted).

nature, rather personal, and should not be regulated, including with zoning. Their guest services are not the same as hotels.<sup>17</sup> However, the hotel industry counters characterizing Airbnb as not only commercial but operating as an illegal hotel without regards to safeguards required by hotels.<sup>18</sup> In considering the arguments, there should be an understanding that hotels, bed and breakfasts, and short-term rentals all offer a service for guests, but their types of services are different. A hotel offers several or hundreds of separate rooms in one facility usually with a full staff of professionals to offer a range of guest services. In contrast to the many separate rooms in one facility is the bed and breakfast, which usually offers a more personalized service with a smaller number of rooms and guest services by the homeowner, normally being present during the stay. Finally, the Airbnb hosts generally offer a single residential unit (apartment, house or room), often operating part-time with very limited professional training and experience, and guest services may be nonexistent with property owners being absent.<sup>19</sup> Because of the limited professional training and experience as well as many absentee property owners, the municipal issues with short-term rentals pop up fly balls for municipal entities to field in providing for the health, safety, and welfare of its citizens.

Many critics of short-term rentals believe that this type of rental furthers the affordable housing crisis by decreasing the housing supply available to long term renters. Specifically, some property owners turn their properties into “mini-hotels.”<sup>20</sup> This conversion is sometimes beneficial to short-term rental owners, because they generate more money in a few months than they could in an entire year with a long-term renter.<sup>21</sup> In addition, the conversion of residential homes within a block area into short-term rental units could potentially destroy an entire neighborhood due to late night parties, loud music, and traffic.<sup>22</sup>

Moreover, cities are concerned that short-term rentals may negatively impact local tax revenues. Until recently, short-term rental hosts were not required to pay the same occupancy taxes levied against traditional hotels. Originally, reporting the host’s income was voluntary with Airbnb leaving it up to the host. However, Airbnb began to reach agreements as early as 2014 with cities like San Francisco to collect hotel-type taxes from the hosts and remit them to the cities. By June of 2016, Airbnb announced it had agreements with 190 cities and states for the collection and remittance of taxes directly from the users to the government.<sup>23</sup> There still remains a question as to whether the tax revenue generated from such remittance is sufficient to cover not only the cost of enforcement but also the cost of displacement of longtime residents.<sup>24</sup>

### **1. Leasing for a Set Time Period**

Cities in the United States usually adopt zoning or similar regulations on short-term leasing of units in residential neighborhoods as a means to protect and promote the quality of life in residential neighborhoods. A standard restriction used sets a minimum term for the leasing of residential units, such as 30 days. However, such a restriction could substantially inhibit the leasing of residences with Airbnb by preventing hosts from engaging in short-term rentals of their primary residences or from turning a residential unit into a full-time short-term rental unit.<sup>25</sup> Short-term rentals defined as 30 days or fewer may also have an adverse impact on the quality of life for neighbors, in particular in apartment buildings, due to the increase of noise, traffic, parties, trash, and the coming and going of strangers. Airbnb hosts have responded that these problems can be addressed by giving condominium boards or homeowners associations sufficient

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<sup>17</sup> FTC Report at 76 (citations omitted).

<sup>18</sup> *Id.*

<sup>19</sup> FTC Report at 75 (citations omitted).

<sup>20</sup> Scott Gruby, “Why Your Short-Term Airbnb Rental Is a Problem,” *Voice of San Diego* (2015).

<sup>21</sup> Hailey Branson-Potts, “Santa Monica Convicts Its First Airbnb Host Under Tough Home-Sharing Laws,” *Los Angeles Times* (2016).

<sup>22</sup> Hugo Martin, “A Surge in Short-Term Rentals Means No R&R for Some Anaheim Residents,” *Los Angeles Times* (2015).

<sup>23</sup> Brian Solomon, “Airbnb to Cities: We Come in Peace, and With Taxes,” *Forbes* (2016).

<sup>24</sup> Deanna Ting, “Airbnb’s Proposed Tax Agreement with Cities Raise More Questions than Answers,” *Skift* (2016).

<sup>25</sup> FTC Report at 85-86 (citations omitted).

authority to address such issues with the adoption of “Airbnb-friendly” or “Airbnb-free” policies, enabling renters or buyers to choose residences based on their preferences.<sup>26</sup> However, this does not address the quality of life for neighbors in residential neighborhoods. These travelers are less concerned about the public health, safety, and welfare of the maintaining the character of the neighborhood as they are supporting their own agenda for their short-term rental.

In Texas, the ordinances have been addressing most short-term rentals to be fewer than 30 days making a division between the short-term rental and the long-term rental. The Texas Comptroller’s Office charges a 6 percent state hotel tax for sleeping accommodations or rooms ordinarily used for sleeping for fewer than 30 consecutive days in compliance with a state law exemption.<sup>27</sup> Consequently, Texas municipalities have adopted the fewer than 30 days for a short-term rental definition to comply with the collections laws. In drafting an ordinance, the definition of a short-term rental is crucial in determining what type of guest service is offered and the number of days that constitutes this type of rental. When considering a wide variety of short-term rental regulations, the community itself must be taken into account, including any legal constraints, policy goals, a willingness of residents to accept tourist presence in residential areas, and general municipal and neighborhood characteristics.

## **2. “Owner Occupancy” or “Owner Presence” Required**

One of the distinctions between the short-term rentals and hotels and/or beds and breakfasts is the argument that no one may be present, and the transient stranger is not as invested into the quality of life in this neighborhood, since he/she may only stay for a short time period. In drafting ordinances that regulate these types of services, the drafter should consider the extent to which an owner should be involved, especially for life safety reasons. The distinction between the “owner occupancy” and “owner presence” has become an issue in some cities where residential neighborhoods in particular value their quality of life and neighborhood cohesiveness unlike investors, who buy homes merely for the purpose of generating money. “Owner Occupancy” requires that the host show proof of room occupancy for the room rented as opposed to “Owner Presence,” which requires that the host be physically present during the rental. In many cities, neighborhood groups advocate for “Owner Presence” restrictions because of the concern for their residential neighborhoods being overcome with “transient populations,” or strangers, who rent homes in their neighborhood without being accountable to their neighbors for maintaining a quality of life. In San Luis Obispo, California, a comprehensive ordinance passed requiring that the rental be owner-occupied. However, owner presence is encouraged but not mandated. To alleviate neighborhood concerns, the city requires the host or a “designated responsible party” to be within a 15-minute drive of the property and available by telephone twenty-four hours a day, seven days a week while rentals are occurring.<sup>28</sup> In the City of Austin’s Ordinance, their licensing requirement includes that there must be a local contact for the property owner or manager, and it requires a primary structure to be “Owner-Occupied” at least 51% of the time<sup>29</sup> The importance of having a designated responsible person is a critical issue, especially when considering life safety type concerns as well as neighborhood disruption by a renter causing loud noise, leaving trashy conditions creating a nuisance, and other potential issues. Conversely, this may limit the number of qualifying properties for short-term rentals.

## **3. Inspections or Licenses**

The municipalities that have opted for short-term rental restrictions determined that adhering to the building and fire codes is major life safety concern. This concern has already been shown in regulations for hotels and beds and breakfasts. As a consequence, some cities require short-term rental inspections or licenses, including but not limited to, protecting the structure’s integrity, regulating fire escapes, and occupancy usage. Madison, Wisconsin limits how often people can rent space, how many rentals must

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<sup>26</sup> FTC Report at 86-87 (citations omitted).

<sup>27</sup> Texas Tax Code Ann., Sections 156.052, 156.053, and 156.101 (Vernon’s 2015).

<sup>28</sup> National League of Cities, *Cities, The Sharing Economy and What’s Next*, p. 22 (2015).

<sup>29</sup> *Short-Term Rental News Release and FAQ* City of Austin Code Department and Austin, Texas, Code of Ordinances No. 20130926-144.

occur before the City can collect taxes, and how often hosts must rent their space before an inspection is required to ensure compliance with building codes. Cities such as Indianapolis and Philadelphia have not adopted ordinances, relying on neighbor reports to resolve issues on a case-by-case basis.<sup>30</sup> The City of Austin arguably adopted a regulatory scheme that some might say is strenuous, while others maintain that the community and neighborhoods wanted enforcement. Austin's controversy is a great example of the tension between serving the community's needs and allowing property owners to pursue this type of service without restraint, arguably discriminating between this service and hotels and bed & breakfasts, who serve the same tourist clientele.

#### **4. Insurance**

A major concern for hosts and renters is whether there is adequate property and liability insurance to protect the renter during the occupancy or the host who may return to a home vandalized or destroyed. This issue occurs since most home owners and renters insurance policies exclude most if not all liability arising out of the insured using the property for commercial purposes. The FTC Report states, "[u]nfortunately, sharing economy participants often do not recognize their potential exposure for injury."<sup>31</sup> A PUC Commissioner warned, "those renting from hosts need to ask, if 'you get a place through Airbnb and you have a slip and fall, are you covered?'"<sup>32</sup> Since Airbnb subsequently expanded their primary insurance coverage for all losses, some cities allow such coverage to account for their insurance coverage required. For instance, Austin requires at least minimal amounts of insurance, whether through the host's personal insurance carrier or the short-term rental property's insurance coverage.

#### **5. Hotel Occupancy Tax Collections**

Another issue for municipalities is to ensure they are receiving payments of the applicable hotel occupancy taxes from the short-term property rentals. In comparison, a short-term rental of a hotel room or bed and breakfast room is also subject to this tax. However, the Federal Trade Commission's concern was the Airbnb hosts largely fail to pay them depriving local governments of this tax revenue source. Consequently, this lack of payment for hotel occupancy tax collections places the traditional providers (hotels and B&Bs) at an unfair competitive disadvantage.<sup>33</sup> One FTC workshop participant stated that the hosts fail to collect taxes, because, "[w]e don't always think that the tax is owed, because someone doing this a week a year is not a hotel."<sup>34</sup> In Texas, the City of Austin, as well as other municipalities, requires that short-term rentals must pay hotel occupancy taxes and show proof of such payment to comply with their ordinance and continue short-term rentals.<sup>35</sup>

So, the question becomes whether to ban short-term rentals from a community, enforce stringent or light restrictions on short-term rentals, or just allow short-term rentals and allow the neighbors to complain, addressing the issue on a case by case basis.

### **III. TEXAS MUNICIPALITIES ATTEMPT THEIR RUN TO HOME BASE**

#### **A. AUSTIN CONTROVERSY**

Probably the most notable Texas community dealing with this issue has been the City of Austin. After several years of debate pitting short-term rental owners against businesses and neighborhood groups, Austin City Council finally voted to allow short-term rentals. Because the short-term rental market was already in operation and so robust in Austin, a ban could not feasibly be enforced. Consequently, the Austin City Council decided that short-term rental owners were going to operate their rental properties, legal or not, and legalizing them would give the City an opportunity to track, regulate, and capture previously lost tax revenues. In crafting their ordinance, the City began a lengthy public review and negotiation process that ended with several compromises, including differentiating between owner-occupied and non-owner-occupied short-term rentals. The

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<sup>30</sup> National League of Cities, *Cities, The Sharing Economy and What's Next*, p. 23-24.

<sup>31</sup> FTC Report at 83 (citations omitted).

<sup>32</sup> *Id.*

<sup>33</sup> FTC Report at 84 (citations omitted).

<sup>34</sup> FTC Report at 85, 537, *quoting* David Hantman.

<sup>35</sup> *See*, Austin, Texas, Code of Ordinances No. 20130926-144.

non-owner-occupied short-term rentals, referred to as “Type 2 STRs,” had a distance between the short-term rentals that are not occupied. This Ordinance ultimately phased out “Type 2 STRs” in residential areas beginning April 1, 2022.<sup>36</sup>

In addition, this Ordinance had various other components that became short-term rental restrictions, including the following new licensing requirements:

- Local contact information for the property owner or manager;
- Proof of a Certificate of Occupancy issued in 2006 or later, or a third party life safety inspection; and
- Limits, by census tracts, on the percentage of short-term rentals in residential and commercial areas.<sup>37</sup>

The new enforcement tools included the following:

- An occupancy limit of no more than ten adults or six unrelated adults;
- Regulations on sound equipment, live music and noise;
- A ban on advertising by non-licensed short-term rentals;
- Prohibition on outdoor assemblies from 10 p.m. to 7 a.m.;
- Ban on commercial events, such as bachelor and bachelorette parties, concerts, weddings and other large events;
- New enforcement actions for repeat offenders; and
- Additional authority to suspend or deny licenses.<sup>38</sup>

However, these new regulations brought opposition from the conservative Texas Public Policy Foundation (TPPF), and they consequently, filed a lawsuit against the City to block the Ordinance from going into effect.<sup>39</sup> To a great extent, their alleged claims in the lawsuit focused on restrictions on occupancy behavior, such as no group activities either indoor or outdoor after 10 p.m., restricting the adult numbers to ten, and prohibiting no more than six persons to be outside during the day. The alleged violations included the following:

1. **Right to Privacy:**

- The plaintiffs contend that these broad restrictions on group activities after 10:00 p.m. violates a tenant’s right to privacy. Specifically, they argue that occupancy and noise complaints fail to be a sufficiently compelling threat to the public’s safety, especially for home activities and essentially bedtimes.

2. **Freedom of Assembly:**

- Plaintiffs next assert that these same restrictions violate the occupant’s freedom of assembly by the Ordinance neither being narrowly tailored nor furthering a compelling state interest (Plaintiffs provide little explanation for this reasoning).

3. **Substantive Rights under Due Course of Law Clause:**

a. **Right to Economic Liberty and Private Property**

- Plaintiffs also allege that the Type 2 rental prohibition unlawfully prevents property owners from using their land for income generation. Also, the maximum cap on unrelated adults is arbitrary and unreasonably requires plaintiffs to keep bedrooms empty. Additionally, this prohibition is not rationally related to the protection of public health, safety, or welfare and is unduly burdensome when considering the government interests.

b. **Right to Freedom of Movement**

- Plaintiffs then discuss three specific provisions that they assert violate their freedom of movement: (1) restricting the number of adults

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<sup>36</sup> *Short Term Rental News Release and FAQ*, City of Austin Code Department available at <http://austintexas.gov/article/short-term-rental-news-release-and-faq> and as described in *The Statesman* online edition, February 2013: <http://www.statesman.com/news/local-govt-politics/austin-broadens-short-term-rental-rules/nWdHG/>.

<sup>37</sup> *Short Term Rental News Release and FAQ*, City of Austin Code Department available at <http://austintexas.gov/article/short-term-rental-news-release-and-faq>.

<sup>38</sup> *Id.*

<sup>39</sup> *Ahmad Zaatari, et al v. City of Austin, and Steve Adler, Mayor of the City of Austin*, Cause No. D-1-GN-16-002620, in the 53<sup>rd</sup> Judicial District Court of Travis County.

allowed in a short-term rental; (2) prohibiting no more than six people to be outside in an “assembly” during the day; and (3) prohibiting any size of indoor or outdoor assemblies at night. Such a broad prohibition is not narrowly tailored nor furthering a compelling state interest.

**c. Ultra Vires Act**

- A city is authorized to use its zoning power only on reasonable restrictions and prohibiting residential uses within a residential district is arbitrary and unreasonable. Additionally, the City using land use regulations to restrict tenant and owner behavior at night is an unlawful attempt to regulate annoying behavior by employing land use restrictions.

**d. Equal Protection**

- Plaintiffs also contend that the Ordinance unlawfully creates three separate distinctions between two similarly-situated classes: (1) rentals for less than 30 days as opposed to those over 30 days; (2) short-term rental tenants as opposed to the long-term rental tenants; and (3) owner-occupied rentals as opposed to non-owner-occupied rentals. These distinctions are not rationally related to a legitimate state interest. Further, they continue by alleging the City chose to discriminate against short-term rentals on the basis of owner occupancy out of prejudice and favoritism.

**e. Unreasonable Warrantless Searches**

- Finally, the Plaintiffs state that Part 7 of the Ordinance gives police the authority to conduct administrative searches “on demand” of all parts of the short-term rentals at all reasonable times.

There were no federal causes of action asserted. As is shown by this lawsuit, a myriad of issues are important to consider when determining the best course of action for a community to take in reviewing short-term rental ordinances. In crafting an ordinance, one community may have concerns because of the character of their community that another community may not have.

Attorney General Ken Paxton has also intervened in support of TPPF’s petition and argues, on behalf of the State, attacking the City’s Ordinance on virtually all the provisions.<sup>40</sup> Type 2 rentals is alleged to violate the state constitutional law as being arbitrary and capricious and an unconstitutional taking of property. However, the Attorney General’s wrath appears to be aimed at Section 25-2-795 of the Ordinance, asserting that the occupancy regulatory provisions violate the state constitutional equal protection provisions, authorize unreasonable warrantless searches, and exceeds the City’s constitutional power to zone property.<sup>41</sup> Essentially, in arguing for the State, the Attorney General states that the city’s ordinance “functionally ousts homeowners and investors from real property without just compensation.”<sup>42</sup> According to the Attorney General, Austin’s short-term rental Ordinance constitutes an unconstitutional regulatory taking of property under both state and federal law, depriving the property owner of their reasonable use and investment backed expectations. In other words, a loss of future short-term rental income reduces the property values, and without such income, the Plaintiffs cannot pay their property taxes, mortgages, maintenance, and home expenses. The focus seems to be an issue of whether the City can stop homeowners from using their property as short-term rental properties, especially when the owner has previously been providing that service.<sup>43</sup>

However, the City of Austin seems to be trying to preserve their housing opportunities for Austin families whether they are renters or owners. A “mini-hotel” next door does not meet that criterion. Zoning laws allow for reasonable limits on property rights, and with Austin’s Ordinance, a property owner can still rent their home as long as

<sup>40</sup> No federal causes of action are asserted in this lawsuit, therefore, the removal to federal court is foreclosed.

<sup>41</sup> Austin Code of Ordinances, Section 25-2-295, “Occupancy Limits for Short-Term Rentals,” provides, in part, that not more than two adults per bedroom plus two additional adults may be present in a short-term rental between 10:00 p.m. and 7:00 a.m.; a licensee or guest may not use or allow another to use a short-term rental for an assembly between 10:00 p.m. and 7:00 a.m.; a licensee or guest may not use or allow another to use a short-term rental for an outside assembly of more than six adults between 7:00 a.m. and 10:00 p.m., and an outside assembly of more than six adults between 7:00 a.m. and 10:00 p.m., and an assembly includes a wedding, bachelor or bachelorette party, concert, sponsored event, or any similar group activity other than sleeping.

<sup>42</sup> Ahmad Zaatari, et al v. City of Austin, et. al, *see supra*, Plea in Intervention of Texas, at 1-3.

<sup>43</sup> *Id.*



the owner lives in the home. Specifically, the homeowner has a property right that should be protected from short-term renters that may take away from those rights.<sup>44</sup> These types of arguments seem to abut the Attorney General's expectations of allowing investment backed housing.

Because this issue is a specific concern for the community of Austin and the types of short-term rental guests that may affect the property rights of homeowners, the City pursues their assertions that their Ordinance has reasonable restrictions for their community. The City filed a no evidence motion for summary judgment arguing among other things that the plaintiffs could not prove any injury as there had been no loss in value for the Plaintiff's properties. The trial judge granted the motion and this case is now on appeal.<sup>45</sup>

## B. THE TEXAS EXPERIENCE

On another front, in Tiki Island, a small incorporated village outside Galveston, property owners filed a lawsuit after the Village adopted an Ordinance prohibiting short-term rentals and argued that the Ordinance constituted a regulatory taking of their property by prohibiting an act that had been allowed for twenty years.<sup>46</sup> The trial court issued a temporary injunction on behalf of the Plaintiff against the Village and held that the Plaintiff had a reasonable, investment-backed expectation that the property owner could engage in short-term rentals.<sup>47</sup> On interlocutory appeal of the injunction, the appellate court affirmed the trial court's ruling. Please note that this case was not ruled on for the merits.<sup>48</sup> The Attorney General's opinion, in the above claim against the City of Austin, was contradictory to the express appellate court holding of this case. He stated that the Village of Tiki Island's short-term rental Ordinance was an unconstitutional property taking in accordance with the appellate court, yet the merits of this case were not heard.

Other case law involving short-term rentals dealt with a property owner at Sun Harbour Cottages in Rockport, Texas.<sup>49</sup> The property owner's association sought a declaration that the restrictive covenant which prohibited short-term rentals should not be enforced. Ms. Rozzle's specific claim was that the homeowners consented to the use of the cottages for short-term rentals due to other homeowners offering their properties for short-term rental, and the association took no action to prevent the violation. At the summary judgment hearing, the trial court concluded that the homeowners' prior allowance of these violations for short-term rentals amounted to an abandonment of the provision and a waiver of the right to enforce it. The evidence showed that the homeowners used their cottages for short-term rentals for the last ten years, and the violations of the covenant were extensive and material, concluding that the homeowners' acquiescence in allowing these violations amounted to a waiver of the right to enforce it. The appellate court affirmed the decision stating such restriction prohibiting short-term rentals was void.

Another case involving a subdivision's restrictive covenants regarding short-term rentals was reviewed by the Austin Court of Appeals, and the River Chase subdivision covenants in Austin were found to be unenforceable.<sup>50</sup> The properties in this subdivision were only to be used "for single family residential purposes," prohibited by the short-term rental of homes in the subdivision. In 2014, the claimants rented their house when they were not in occupancy for not more than thirty days. Subsequently, the homeowners association demanded that the Plaintiffs stop all short-term and vacation rentals and online advertising of their property, since the owner was in violation of the restrictive covenants. Later, they moved to a different home and retained their house in the River Chase subdivision as a rental property. During the trial, the house was rented under a one year lease, and the Plaintiff intended to continue advertising and renting the house for varying lengths of time, paying hotel and lodging taxes when the house rented for fewer

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<sup>44</sup> Ahmad Zaatari, et al v. City of Austin, and Steve Adler, Mayor of the City of Austin, Cause No. D-1-GN-16-002620, in the 53<sup>rd</sup> Judicial District Court of Travis County.

<sup>45</sup> *Id.*

<sup>46</sup> Village of Tiki Island v. Ronquille, 463 S.W.3d 562 (Tex. App. – Houston [1<sup>st</sup> Dist.] 2015, no pet.).

<sup>47</sup> *Id.*

<sup>48</sup> The Attorney General, however, characterized the *Tiki Island* decision a bit differently in his Plea in Intervention in the *Zaatari* case, portraying the holding in *Tiki Island* as an on the merits determination of a regulatory taking.

<sup>49</sup> Friedman v. Rozzle, 2013 WL 6175318 (Tex. App.—Corpus Christi 2013, pet. denied).

<sup>50</sup> Zgabay v. NBRC Property Owners Association, 2015 WL 5097116 (Tex. App. – Austin 2015, pet. denied).

than thirty days.<sup>51</sup>

On appeal, the Plaintiff sought declaratory relief stating that the restrictive covenants do not prohibit short-term rentals or otherwise restrict rentals based on duration, and the house's rental to an individual or single family for residential use is considered a "single family residential purpose" that is allowed under the restrictive covenants. Reversing the trial court, the appellate court used the rules of contract construction to interpret the applicable restrictive covenants. Specifically, the covenants did not have a time limit for a resident's lease, and the drafters were likely familiar with the time limit concept. The lack of time limits for the lease rendered the restrictive covenant ambiguous. Consequently, the Court resolved the ambiguity against the homeowner's association and in the Plaintiff's favor for their free and unrestricted property use.

Finally, the Texas Supreme Court weighed in with its opinion regarding a restrictive covenant in San Antonio's Timberwood Park subdivision prohibiting a use other than single-family use did not affect short-term rentals.<sup>52</sup> The trial court concluded that a homeowner violated the restriction by having a business operation on a residential tract and engaging in multi-family, short-term rentals. The Court of Appeals affirmed holding the rental agreements contradict the residential purpose of the restrictions. The Supreme Court reversed the two other Court's determination.

The Plaintiff purchased a single-family home in this subdivision, but was transferred by his employer two years later to Houston. He then began leasing his home with short-term rental agreements. The Association notified Tarr that the home rental violated two deed restrictions: (1) a residential purpose covenant, and (2) a single-family residence covenant. The Association argued that renting the home was similar to using it as a hotel, a commercial use, since the short-term renters do not intend to stay in the house. The owner was fined for each day he continued this use.<sup>53</sup>

The Supreme Court, overruling the previous courts, concluded that the "single-family" restriction speaks only to the structure, not the use. The Association's business use restriction does not have a definition of what is considered a "residential purpose" or "business purpose."<sup>54</sup> Absent these definitions, the Court went through a normal construction analysis of an Ordinance, and then, used a common definition for the terms. As long as the activities within the home were those used as a residence, then the Court found the fact that renters occupied the property for a short time frame was irrelevant to the analysis. Unlike a hotel [or bed and breakfast], the rental groups were alone in the house without services, such as cooked meals or housekeeping or any other type of business activity or service. Therefore, the normal residential activities were considered by the Court.<sup>55</sup> As a result of this Supreme Court opinion, any City that regulates in any manner the short-term rentals should include a definition of residential purposes and commercial or business purposes.

A quick review of these cases shows that the enactment of short-term rental restrictions continues to be unchartered legal territory. The outcome of Austin's lawsuit and the Texas legislature's incentive to pass future laws to either guide the enactment of such Ordinances or totally preempt the cities from regulating short-term rentals will certainly give more guidance to cities grappling with the effects of short-term rentals within its neighborhoods. Unfortunately, the legislature continues to vacate municipal authority in favor of the State passing uniform laws ignoring the individual community's needs based on their cities character. For example, South Padre Island may have different issues and problems based on their destination tourism, ocean geographic, and resident's expectations when buying in this community than Amarillo. In other words, not all cities are the similar in the citizens that they serve.

### C. TEXAS LEGISLATION

The Texas Legislature has considered bills in the last two legislative sessions.

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<sup>51</sup> Id.

<sup>52</sup> Tarr v. Timberwood Park Owners Association, Inc., 556 S.W.3d 274 (Tex. 2018).

<sup>53</sup> Id. at 278.

<sup>54</sup> Id. at 289-292.

<sup>55</sup> Id.

The following summary of the types of things considered can guide a drafter of a short-term rental ordinance to evaluate the issues presented to our legislators. Those issues are as follows:

1. The 85<sup>th</sup> Texas Legislature.

- Senate Bill 451 was introduced by North Richland Hills State Senator Kelly Hancock, which would have prevented Texas cities and counties from banning or restricting short-term rental property to an extent. A short-term rental was defined to mean “a residential property, including a single-family dwelling or a unit in a condominium, cooperative, or time-share, which is rented wholly or partly for a fee for a period not longer than 30 consecutive days.” The short-term rental ordinance adoption and enforcement of regulations could include those addressing fire and building codes, health and sanitation, traffic control, and solid or hazardous waste and pollution control. Also, the bill would allow an emergency contact designation for the property. In addition, a provision of the bill permitted local governments to regulate short-term rental property for sex offenders, those selling illegal drugs or alcohol to guests, or a sexually oriented business purpose.<sup>56</sup>

2. The 86<sup>th</sup> Texas Legislature.

- House Bill 3773 was introduced by Angie Button, Richardson, and Senate Bill 1888 was introduced by Senator Pat Fallon, Prosper, to amend the Local Government Code to define a short-term rental and a listing service and allow municipalities to prohibit the following:
  - Use of the unit to promote illegal activities;
  - Management of the unit by a registered sex offender or anyone convicted of a felony;
  - Serving food to a tenant (unless otherwise authorized by law);
  - Rental of a unit to anyone younger than eighteen; and,
  - Rental of the unit for less than twenty-four hours.

The following allows municipalities to require:

- Registration of the unit;
- An emergency contact designation;
- Annual inspection;
- Post permit number on advertising listings;
- Either – a unit provider/property manager to maintain property and liability insurance as required, or proof provided that the listing service is maintaining such insurance;
- Suspend a permit by meeting the burden of proof;
- Limit the maximum occupancy of individuals, so long as that limitation is not less than two individuals multiplied by the number of bedrooms plus two additional individuals; and
- Limitation of registration requirements.

Municipalities prohibited from adopting or enforcing the following ordinances:

- Prohibit or limit the property use for short-term rentals;
- Apply solely to short-term rentals or providers/tenants of short-term rentals; and
- Apply municipal laws that are more restrictive for short-term rentals or inconsistent with the application to other similarly situated property or persons.

Restrictions for Associations acting within their jurisdiction, restrictions in leases, and restrictions in covenants or easements are allowed.<sup>57</sup>

- House Bill 3778 was introduced by Angie Button, Richardson, to create a section of the Local Government Code summarized as

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<sup>56</sup> <https://www.texas-tribune.org/2017/02/25/bill-would-overrule-local-legislation-over-short-term-rentals/>.

<sup>57</sup> Texas Legislative Acts, 2019, 86<sup>th</sup> Leg. Session.

follows:

- All of the above (*see* HB 3773 and SB 1888);
  - Allows municipalities to place a reasonable density restriction or per capita percentage restriction on permits issued for short-term rental units in residential areas;
  - Outlines requirements for short-term rental unit listing services;
  - Outlines requirement for the comptroller to maintain a state-wide database (and for cities to notify them when adopting an ordinance, since it has been difficult for cities to collect alone); and
  - Address reporting ongoing requirements to facilitators of short-term rentals that do not collect tax.<sup>58</sup>
- House Bill 3779 also was introduced by Angie Button, Richardson, and Senate Bill 1472 was introduced by Beverly Powell, District 10, in Tarrant County, which also amended the Tax Code by adding the following:
    - Adds definitions;
    - Requires a short-term rental marketplace to collect appropriate tax amounts for each booking charge, and then, report and remit all taxes as required;
    - Allows a short-term rental marketplace to enter into an agreement with a third party vendor to remit taxes collected by comptroller;
    - Requires municipalities to approve agreements with either the comptroller or the third party vendor;
    - Outline information required for the form used to report taxes;
    - Outline procedures for the comptroller for depositing taxes, communication with the municipality, and limitation for deductions from distributions to the municipality for the state's charge for services; and
    - Require the county's governing body to approve agreements with either the comptroller or a third party vendor.<sup>59</sup>

In response to these bills, there are some noncontroversial proposals that have to do with the cities collecting the short-term rental tax. People renting short-term rental properties already have the state tax included in the itemized receipt. However, cities are each one acting alone in collecting their taxes, and administratively, this has not been the easiest thing to do. Basically, these bills level the playing field and include city taxes in the listing price. The comptroller would be allowed to collect both the state and city taxes, and then, deposit that money to a city or county once a month for amounts owed.

However, the more controversial bills restrict municipalities on their authority by doing away with what the State calls “patchwork” city ordinances. The larger concern is how cities restrict properties rented out when the owners may not live at the property. Austin, as discussed above, is banning those Type 2 properties, while San Antonio allows Type 2 properties, but places a cap on how many can be rented in a single residential block.<sup>60</sup> The concern of most cities seems to be the investor-owned properties, and the rental tenants' lack of responsibility for the neighborhood or residential character. Though many may be responsible, there are always those that do not take care of the tenants or the property the way a hotel or bed and breakfast does with on-premise personnel to attend to guest services. Because of this tension between property owners advocating rentals for income purposes and residential neighborhoods protecting the integrity and character of their homes, the legislature will probably revisit this debate.

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<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *See*, Austin, Texas, Code of Ordinances, No. 20130926-144 and San Antonio, Texas, Code of Ordinances, Article XXII, Short Term Rentals.

#### IV. EXTRA INNINGS ARE REQUIRED FOR TEXAS MUNICIPALITIES TO COME TO A SATISFACTORY CONCLUSION FOR ALL COMMUNITIES

As presented, the “sharing economy” does create multiple municipal issues with the short-term rental properties that require cities to field pop up fly balls in a multitude of legal concerns. As has been seen, some cities, such as Austin, enforce strict restrictions that regulate short-term rentals, while other cities opt not to enforce or otherwise address short-term rentals in their municipalities. This multicolored patchwork of different ordinances across the State shows the dissimilar characteristics of the individual communities and neighborhoods in Texas cities. For example, the makeup of Austin’s community and their tourism may demand more strenuous restrictions than other cities to maintain the integrity of its neighborhoods. In Grapevine,<sup>61</sup> their community decided that short-term rentals should be banned. This difference of approaches explicitly shows the need for the municipalities to determine the needs of their citizens. After all, local government is closer to the people than any other governmental entity, and consequently, it is more perceptive of the laws, necessary or not, to provide for the health, safety, and welfare of its citizens.



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<sup>61</sup> “Arlington takes first steps to limit short-term rentals but faces threat,” *Fort Worth Star-Telegram*, April 9, 2019. Residents sued the City of Grapevine for its existing Ordinance that banned short-term rentals. The Judge issued a temporary injunction against the ban, and a trial is scheduled July 15, 2019.