

Land Use and Economic Development Challenges Affecting City Government

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**Texas Leadership Institute
May 9, 2006**

I. Introduction

City governments that seek to stimulate responsible economic development and at the same time regulate growth face unique challenges. Recognizing this, the Texas Legislature has created multiple avenues through which a city may offer economic incentives to property owners in order to achieve a public purpose. Like private entities, municipalities can enter into contracts. *See, e.g., City of Bonham v. Southwest Sanitation, Inc.*, 871 S.W.2d 765, 767 (Tex. App.-Texarkana 1994, writ denied). As the Texas Legislature has expanded the economic development tools available to municipalities, it has restricted the land use controls available to cities. As a result, cities are increasingly looking to contractual arrangements to regulate the use of land and to provide economic development opportunities.

II. Potential Economic Development Tools

A. Chapter 380 Economic Development Agreements

Chapter 380 of the Texas Local Government Code was enacted to implement article III, section 52-a of the Texas Constitution, which essentially establishes that economic development is a public purpose. Op. Tex. Atty Gen. Nos. GA-0071 (2003); JC-0092 (1999); DM-185 (1992). In general, Section 380.01 authorizes municipalities to offer a range of local incentives to promote state or local economic development. Op. Tex. Atty Gen. No. DM-185 (1992). Examples include programs for making loans and grants of public money and providing personnel and services of the municipality, to promote state or local economic development and to stimulate business and commercial activity in the municipality. TEX. LOC. GOV'T CODE Section 380.001(a). The Attorney General has recognized that a municipality may constitutionally finance a Chapter 380 Economic Development Agreement in whole or in part through sales tax rebates. Op. Tex. Atty Gen. No. GA-0071 (2003).

Specifically, the statute authorizes grants and loans from city funds for economic development purposes. TEX. LOC. GOV'T CODE ANN. Section 380.001 (Vernon 1999 & Supp. 2004). The statute does not provide for a funding source for such grants and loans, such as a tax or fee.

Limitations on the funding of such programs do exist. A home-rule municipality can issue bonds to fund an economic development program under the statute, but only if two conditions are met: (1) the bonds must be in an amount and to the extent provided by the municipality's charter and (2) a majority of the qualified property tax-paying voters voting at an election must approve the issuance of the bonds. Op. Tex. Atty Gen. No. DM-185 (1992). Funds granted under section 380.002 to a Section 501(c)(3) corporation or a 4A or 4B development corporation by a home-rule city cannot be from the proceeds of bonds or other obligations of the municipality payable from ad valorem taxes. TEX. LOC. GOV'T CODE ANN. Section 380.002(c) (Vernon 1999 & Supp. 2004). Pursuant to section 380.002(b), a home-rule municipality may grant public money to a 4A or 4B economic development corporation created by the municipality under the Development Corporation Act of 1979 (Article 5190.6, Vernon's Texas Civil Statutes). A city cannot abate delinquent taxes as an economic development program under the statute. Tex. Atty Gen. LO-95-090.

As with all economic development projects, a municipality must insure that the use of the funds for a Chapter 380 project are consistent with the authorized use of the funds. This requires that all statutes and "contracts with the voters" be carefully analyzed prior to obligating any funds. Jeanene McIntyre, BASICS REGARDING ECONOMIC DEVELOPMENT TOOLS FOR MUNICIPAL ATTORNEYS, presented at TML Conference (Feb. 2003).

In 2004 an environmental group from Travis County opposed to a project that was to be funded in part through a Chapter 380 program filed suit and challenged the constitutionality of Chapter 380 economic development programs. In response to the lawsuit and because of the importance of Chapter 380 programs to the success of economic development in Texas, the Legislature in 2005 proposed a Constitutional amendment to clarify that Chapter 380 programs were authorized by the Texas Constitution. This amendment was approved by the voters in November 2005 thus removing the cloud of uncertainty created by the lawsuit.

One of the more popular Chapter 380 programs for economic development of commercial or retail projects involves the use of sales tax. By contract the city funds the public improvements needed for the development by agreeing to refund sales tax generated by the development back to the developer. Cities and developers alike have found these types of programs to be very effective in increasing economic development. The developer receives assistance that makes the development possible, the city is not required to front any money or to pay for any of the public improvements with ad valorem taxes and the city receives improved property that will generate increased ad valorem, new jobs in the community and additional sales taxes.

Important Elements of a 380 Agreement:

- ✓ Limit the term of the Agreement. The developer shouldn't expect the city to pay sales tax rebates forever.
- ✓ Limit the percentage of sales tax and place a cap on the maximum amount that the developer can collect.
- ✓ Tie the development requirements and other major terms and conditions of the agreement into

- the developer's right to collect the rebate.
- ✓ If the city will own the public improvements after construction, then the competitive bidding requirements may apply.
- ✓ Describe how much the development can change in design before the agreement must be amended.
- ✓ Consider whether or not the developer will be allowed to assign the 380 agreement or the payments under the agreement.
- ✓ Set some start dates and project completion dates.
- ✓ Make sure that the requirement for the commencement of 380 payments to the developer does not occur until after the city begins to receive sales tax from the project.
- ✓ Require the developer to assist with documentation of the amounts of sales tax generated by a particular retail establishment.
- ✓ Make sure that the city's obligation to make payments is limited to the sales tax generated by the specific project and actually received by the city and that other sources of city funds are not implicated.

B. Planned Development Districts

Planned development districts (PDDs) "allow developers to obtain site-specific approval for development that may not fit standard area and use zoning categories and that require specific negotiation to ensure that community interests are protected." John Mixon, *TEXAS MUNICIPAL ZONING LAW*, at 7-30 (3d ed. 2003). Unlike special exceptions, PDDs constitute zoning amendments.

Planned development district zoning is an especially effective regulatory mechanism when developers want to use land for a purpose that is not allowed under the city's zoning ordinance. *Id.* at 7-32. Since developers are not entitled to PDD permits as a matter of right, a city usually has a very strong bargaining position to effectuate specific land use controls and to mitigate the impacts of the proposed development if necessary. Similarly, the developer may favor a PDD approach as it allows the developer to be more creative in the design and utilization of the property.

Under a PDD process, the municipality may require the developer to build the project according to an approved site plan or concept plan and to, for example, landscape buffer areas, install traffic controls and construct paving to accommodate the new development. *See id.*

Planned development zoning must be carefully crafted, as PDDs can run afoul of contract zoning prohibitions if the city attempts to bind developers to bilateral contracts to build approved projects and fulfill other conditions (which may include dedications of public areas). *See id.* at 7-39.

C. Development Agreements

Texas Local Government Code Chapter 212 authorizes cities with a population of more than 5,000 (generally home-rule municipalities) to enter into development agreements with subdividers/owners of property. A development agreement is a negotiated contract between the parties which establishes development standards and restrictions. Kimberley Mickelson, THE AUTHORITY OF MUNICIPALITIES TO RESOLVE LAND USE MATTERS BY CONTRACT, presented at UNIV. OF TEX. CONF. ON LAND USE PLANNING LAW, (Feb. 2003).

Subchapter C, Chapter 212, Texas Local Government Code allows cities to contract with developers to construct public improvements, not including a building, without complying with the bidding requirements of Chapter 252 of the Local Government Code. TEX. LOC. GOV'T CODE ANN., Section 212.071 (Vernon 1999 & Supp. 2004).

Section 212.072(b) provides that under the contract, the developer is to construct the improvements and the city is to participate only in the costs. In this way, the statute serves as a funding mechanism for developers. A development agreement under Chapter 212 must establish the limit of participation by the city which can not exceed 30% of the total contract price (or costs of the improvements) except that a city's participation can be up to 100% of the cost of oversizing of improvements required by the city. *See id.* at Section 212.072(b).

The municipality's participation can be determined as a lump sum or factor or percentage of the total cost of the improvements as determined by municipal ordinance. *See id.* Under that same ordinance, a municipality can require safeguards, beyond the mandatory performance bond, to protect the city against undue loading of cost, collusion, or fraud. *See id.* at Sections 212.073-074. All the developer's books on the project shall be made available to the city for inspection. *See id.* at Section 212.074(b).

Development agreements can represent a win-win for cities and developers. These agreements give cities control over the quality of development while at the same time insuring some stability of development regulations for developers in that regulations for the project are essentially "frozen" for the time set out in the contract. The importance of this fact remains unclear in light of the existence of the Texas Vested Rights Statute, Chapter 245 of the Texas Local Government Code. Kimberley MICKELSON, THE AUTHORITY OF MUNICIPALITIES TO RESOLVE LAND USE MATTERS BY CONTRACT, presented at UNIV. OF TEX. CONF. ON LAND USE PLANNING LAW, (Feb. 2003).

D. ETJ Development Agreements

During the 2003 regular session, the Texas Legislature enacted a new law that authorizes cities to contract with landowners in the cities' ETJ. The statute gives cities broad discretion regarding the terms of such agreements, including the right to provide for terms regarding annexation:

The governing body of a municipality may make a written contract with an owner of land that is located in the extraterritorial jurisdiction of the municipality to:

- (1) guarantee the continuation of the extraterritorial status of the land and its immunity from annexation by the municipality for a period not to exceed 15 years;
- (2) extend the municipality's planning authority over the land by providing for a development plan to be prepared by the landowner and approved by the municipality under which certain general uses and development of the land are authorized;
- (3) authorize enforcement by the municipality of certain municipal land use and development regulations in the same manner the regulations are enforced within the municipality's boundaries;
- (4) authorize enforcement by the municipality of land use and development regulations other than those that apply within the municipality's boundaries, as may be agreed to by the landowner and the municipality;
- (5) provide for infrastructure for the land, including:
 - (A) streets and roads;
 - (B) street and road drainage;
 - (C) land drainage;
 - (D) water, wastewater, and other utility systems;
- (6) authorize enforcement of environmental regulations;
- (7) provide for the annexation of the land as a whole or in parts and to provide for the terms of annexation, if annexation is agreed to by the parties;
- (8) specify the uses and development of the land before and after annexation, if annexation is agreed to by the parties; or
- (9) include other lawful terms and considerations the parties consider appropriate.

TEX. LOC. GOV'T CODE Section 212.171(b). A municipality may not require an agreement under this statute as a condition for providing water, sewer, electricity, gas, or other utility service from a municipally owned or municipally operated utility that provides any of those services. *Id.* at Section 212.174. However, often the provisions of such services form a necessary part of these agreements. On its face, the statute appears to apply uniformly to home rule and general law cities.

An ETJ Development Agreement must be in writing, contain an adequate legal description of the subject territory, be approved by both the city and the landowner, and be recorded in the real property records of all the counties in which the territory is located. *See id.*

While such an agreement gives cities broad power over land they otherwise have limited control over, the agreement is advantageous to the landowner in that the agreement constitutes a permit under the Vested Rights Statute and thus freezes the land use regulations that are applicable to the subject territory. *See id.* at Section 212.172(g).

Importantly, the statute validates any agreements entered into between landowners and cities prior to the effective date of the statute, as long as the agreement complies with the statutory requirements. *See id.* at Section 212.172(h).

To some extent, the powers that the Legislature granted municipalities under section 212.171 mirror those in effect prior to 2003 under section 42.044 of the Local Government Code (Creation of Industrial District in Extraterritorial Jurisdiction). Pursuant to section 42.044, a municipality may enter into an Annexation agreement through which the municipality agrees not to annex business property in a designated industrial district for a period up to fifteen (15) years. The term "industrial district" is defined to include its ordinary meaning in addition to any area where tourist-related businesses and facilities are located. TEX. LOC. GOV'T CODE Section 42.044. Although similar, section 42.044 is more restrictive than section 212.174. In addition to providing a wider menu of contract term options, section 212.171 does not require cities to designate an industrial district prior to entering into an agreement.

E. Property Tax Abatement

In certain circumstances, a city may grant an ad valorem tax exemption for all or a portion of taxable value added by a project located on property in an area designated by the city as a reinvestment zone. TEX. TAX CODE Sections 312.001 *et seq.* To be designated as a reinvestment zone, an area must meet the following criteria:

- (1) substantially arrest or impair the sound growth of the municipality creating the zone, retard the provision of housing accommodations, or constitute an economic or social liability and be a menace to the public health, safety, morals, or welfare in its present condition and use because of the presence of:

(A) a substantial number of substandard, slum, deteriorated, or deteriorating structures;

(B) the predominance of defective or inadequate sidewalks or streets;

(C) faulty size, adequacy, accessibility, or usefulness of lots;

(D) unsanitary or unsafe conditions;

(E) the deterioration of site or other improvements;

(F) tax or special assessment delinquency exceeding the fair market value of the land;

(G) defective or unusual conditions of title;

(H) conditions that endanger life or property by fire or other cause; or

(I) any combination of these factors;

(2) be predominantly open and, because of obsolete platting, deterioration of structures or site improvements, or other factors, substantially impair or arrest the sound growth of the municipality;

(3) be in a federally assisted new community located in a home-rule municipality or in an area immediately adjacent to a federally assisted new community located in a home-rule municipality;

(4) be located entirely in an area that meets the requirements for federal assistance under Section 119 of the Housing and Community Development Act of 1974 (42 U.S.C. Section 5318);

(5) encompass signs, billboards, or other outdoor advertising structures designated by the governing body of the municipality for relocation, reconstruction, or removal for the purpose of enhancing the physical environment of the municipality, which the legislature declares to be a public purpose; or

(6) be reasonably likely as a result of the designation to contribute to the retention or expansion of primary employment or to attract major investment in the zone that would be a benefit to the property and that

would contribute to the economic development of the municipality.

Id. at Section 312.202(a)(1). Property subject to a tax abatement agreement may be located in a municipality's extraterritorial jurisdiction. *Id.* at Section 312.204(c). In that event, the agreement will apply to taxes of the municipality if the municipality annexes the property during the period specified in the agreement. *Id.* Further, a taxing unit may enter into tax abatement agreement with the owner or owner of a leasehold interest in real property. *Id.* at Section 312.204(a) and 312.402(a).

The Attorney General has recognized that the movement of a structure from one location on a piece of beach property to another in order to remove the structure from a public beach may constitute a "specific improvement or repair" to the property within the meaning of section 312.204(a) of the Tax Code. Op. Tex. Atty Gen. No. JC-0106 (1999).

F. Tax Increment Financing

Similar to a tax abatement agreement, a Tax Increment Financing (TIF) Agreement permits a municipality to designate a "TIF" zone (a.k.a reinvestment zone) to fund projects within the zone through additional tax dollars generated by growth of real property value in the zone. TEX. TAX CODE Section 311.001 *et seq.* To be designated as a reinvestment zone under the TIF statute, an area must meet the following criteria:

(1) substantially arrest or impair the sound growth of the municipality creating the zone, retard the provision of housing accommodations, or constitute an economic or social liability and be a menace to the public health, safety, morals, or welfare in its present condition and use because of the presence of:

(A) a substantial number of substandard, slum, deteriorated, or deteriorating structures;

(B) the predominance of defective or inadequate sidewalks or streets;

(C) faulty size, adequacy, accessibility, or usefulness of lots;

(D) unsanitary or unsafe conditions;

(E) the deterioration of site or other improvements;

(F) tax or special assessment delinquency exceeding the fair market value of the land;

(G) defective or unusual conditions of title;

(H) conditions that endanger life or property by fire or other cause; or

(I) any combination of these factors;

(2) be predominantly open and, because of obsolete platting, deterioration of structures or site improvements, or other factors, substantially impair or arrest the sound growth of the municipality; or

(3) be in a federally assisted new community located in a home-rule municipality or in an area immediately adjacent to a federally assisted new community located in a home-rule municipality; or . . .

(4) be an area described in a petition requesting that the area be designated as a reinvestment zone, if the petition is submitted to the governing body of the municipality by the owners of property constituting at least 50 percent of the appraised value of the property in the area according to the most recent certified appraisal roll for the county in which the area is located.

Id. at Section 311.005(a). The Attorney General has determined that an area designated for TIF treatment must be “unproductive, underdeveloped or blighted” w/in the meaning of article VIII, section 1-g(b) of the Texas Constitution. Op. Tex. Atty Gen. No. JC-0152 (1999).

The statute appears to apply uniformly to both general law and home-rule municipalities. If property that is to be subject to a TIF Agreement is located within a city’s extraterritorial jurisdiction or beyond, the property is not eligible for tax increment financing until annexed. ATTORNEY GENERAL OF TEXAS, HANDBOOK ON ECONOMIC DEVELOPMENT LAWS FOR TEXAS CITIES, at 97 (2002).

III. Conclusion

Cities must walk a tight rope between increasing economic development and managing growth through effective regulation of land use and development. By contracting with developers and making the developer a partner rather than an adversary, however, a city can hope to maintain a measure of control over growth while at the same time avoiding costly litigation or avoiding urban sprawl. In addition, the city can often obtain concessions from the developer through these types of agreements and programs that it might not otherwise be able to force on the developer. With a little bit of careful planning, cities can take full advantage of the valuable economic development tools that the Legislature has placed at their disposal while continuing to maintain the character of the community through managing growth.

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