

Land Use and Economic Development Challenges Affecting City Government

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**18th Annual Local Government Seminar
April 26, 2007**

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 to promote self-sustaining developments with amenities and at the same time provide economic development opportunities.

II. 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). Article III, section 52(a) of the Texas Constitution prohibits political subdivisions, including cities, from lending their credit or granting public money to individuals, corporations and associations. The Attorney General has stated in Opinion Number JM-1227 (1990) that the constitutional provision permitting the expenditure of funds to promote economic development purposes was an exception to the constitutional prohibition on lending public credit.

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.

There are limitations on the funding of such programs. A home-rule municipality may 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. Further the Texas Attorney General has recently opined that a city may make a loan to a private developer for a private housing project if it will promote economic development within the meaning of the constitution and statute, even though housing is not specifically cited in the statute. Op. Tex. Atty Gen. No. GA-0529 (2007). The plain language of the statute does not limit the governing body to specific programs or projects but requires that the purpose of the program must be to foster and promote economic development. Op. Tex. Atty Gen. Nos. GA-0529 (2007); DM-185 (1992).

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 as permitted under the law. 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 receives improved property that will generate increased ad valorem, new jobs in the community and additional sales taxes.

Important Elements of a 380 Agreement:

- Ø It is important to understand the transaction and the potential financial implications in order to frame and draft the remaining terms of the agreement.
- Ø Limit the term of the Agreement. The developer should not expect the city to pay sales tax rebates forever.
- Ø Limit the percentage of sales tax and place a cap on the maximum amount that the developer can collect.
- Ø Tie the development requirements and other major terms and conditions of the agreement to the developer's right to collect the rebate.
- Ø If the city will own the public improvements after construction, then the competitive bidding requirements may apply.
- Ø Describe how much the development can change in design before the agreement must be amended.
- Ø Consider whether or not the developer will be allowed to assign the 380 agreement or the payments under the agreement.
- Ø Establish start dates and project completion dates.
- Ø 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.
- Ø Require the developer to assist with documentation of the amounts of sales tax generated by a particular retail establishment.
- Ø 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.
- Ø Termination and recapture. In case of termination and the developer does not abide by the terms of the agreement, the city should be reimbursed for any incentives already provided.

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. The PDD can also be utilized to permit varied dimensional standards such as floor area, setbacks and height requirements. Since developers are not entitled to PDD zoning 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, provide landscape buffer areas, install traffic controls and construct street improvements to accommodate the new development. *See id.* Other issues such as signage, lighting, fencing and construction materials may be addressed as part of the PDD ordinance.

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 amount of participation by the city which cannot exceed 30% of the total contract price (or costs of the improvements). A city may participate up to 100% of the cost of oversizing of improvements required by the city, including but not limited to, increased capacity of improvements to anticipate other future development in the area. *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 and records 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 construction of necessary infrastructure for the current and future developments without having to comply with statutory notice and bidding requirements, while at the same time assisting developers in the funding of such improvements.

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 the timing of 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 212.172(b). A city 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 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.* at Section 212.172(c).

These agreements give cities broad power over land they otherwise have limited control over. Municipalities may extend their subdivision regulations in the ETJ; however, they may not regulate typical zoning issues such as uses, bulk, height and density. *See id.* at Section 212.003. If the land is occupied upon annexation there is a chance that the property contains significant nonconforming uses and structures. Under these types of agreements, when the property is annexed there should be little to no nonconforming uses and structures as the regulations and uses have been detailed in the agreement. The agreement is advantageous to the landowner providing some assurance as to the continued status of the property in the ETJ and setting forth a timetable for annexation. The agreement constitutes a permit under the vested rights statute, Chapter 245 of the Local Government Code, and unless otherwise provided for in the agreement, 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 city 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 same criteria for the creation of a reinvestment zone for a property tax abatement. *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 Attorney General has expanded on their opinion and concluded that even if the area's plan of tax increment financing does not include the issuance of bonds or notes the city may not designate an area as an investment zone unless the area is "unproductive, underdeveloped, or blighted". Op. Tex. Atty Gen. No. GA-0514 (2007).

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).

G. PUBLIC IMPROVEMENT DISTRICT

The Public Improvement District Assessment Act found in Chapter 372, Subchapter A of the Local Government Code establishes the regulations for establishing a Public Improvement District (PID) and the levy of assessments on property included within the district. A PID allows the governing body of a city or county to apportion the cost of an improvement and levy an assessment against the property located in the PID, because the property within the district is acquiring a special benefit because of the improvement. TEX. LOC. GOV'T CODE Section 372.015. This promotes economic growth by providing the funding mechanism to construct critical infrastructure necessary to support new developments and encourage redevelopment.

A PID may be initiated by a municipality, county or by petition filed with the municipal secretary. *Id.* at Section 372.002. A city may object to the creation of a PID by a county located within the city's limits or city's ETJ. The petition must describe in general the nature of the proposed improvement, the estimated cost, the proposed boundaries, proposed method of assessment, the proposed apportionment of cost between the PID and government, who will manage the PID, that the persons signing the petition request or concur with the establishment of the district.

The petition must be signed by:

(1) owners of taxable real property representing more than 50 percent of the appraised value of taxable real property liable for assessment under the proposal, as determined by the current roll of the appraisal district in which the property is located; and

(2) record owners of real property liable for assessment under the proposal who:

(A) constitute more than 50 percent of all record owners of property that is liable for assessment under the proposal; or

(B) own taxable real property that constitutes more than 50 percent of the area of all taxable real property that is liable for assessment under the proposal. *Id.* at Section 372.005.

The cost of the improvement may be assessed equally per front foot or square foot, according to the value of the property or in any other manner imposing equal shares of the cost on similarly benefited property. *Id.* at Section 372.015. The governing body may establish by ordinance or order the reasonable classifications and formulas for the apportionment of the cost between the municipality or county and the area to be assessed; and (2) the methods of assessing the special benefits for various classes of improvements. *Id.*

A PID may be created to promote the interests of the city or county and the statute includes a lengthy list of improvement projects ranging from acquisition, construction and improvement of a variety of municipal improvements including parks, facilities as well as addressing utility issues, streets and other quality of life improvements. *Id.* at Section 372.003.

Once a petition is filed the governing body may make findings by resolution as to the advisability of the proposed improvement, its estimated cost, the method of assessment, and the apportionment of cost between the proposed improvement district and the municipality or county as a whole. *Id.* at Section 372.006 The city or county may appoint an advisory body with the responsibility of developing and recommending an improvement plan to the governing body and the statute sets forth the composition of the advisory body. *Id.* at Section 372.008.

In order to establish a PID a public hearing must be held on the advisability of the improvement, and the following findings must be made by resolution:

(1) the advisability of the improvement;

- (2) the nature of the improvement;
- (3) the estimated cost of the improvement;
- (4) the boundaries of the public improvement district;
- (5) the method of assessment; and
- (6) the apportionment of costs between the district and the municipality or county as a whole. *Id.* at Section 372.009.

Notice of the public hearing must be given in a newspaper of general circulation as well as mailed to each owner of the property proposed to be included in the PID at least fifteen days prior to the hearing, and must include specific information regarding the PID. *Id.* Governments must be careful of the information included in the notice. If the area is not included in the notice then it may not be assessed unless a hearing is held to include the property and notice for the hearing is provided. *Id.* at Section 372.012.

In addition to being aware of the information contained in the public notice, the city or county needs to be cognizant of the creation and adoption of an ongoing service plan, which shall include a period of at least five years and must also define the annual indebtedness and the projected costs for improvements, as well as the creation of an assessment plan which must be included in the annual service plan, and the assessment roll. *See id.* at Sections 372.013, 372.014, 372.016.

After completion of the public hearing and findings are made as to the creation of the PID, a PID takes effect when it has been published one time in a newspaper of general circulation, and actual construction of an improvement may not begin until after the 20th day after the date the authorization takes effect and may not begin if during that time written protests are filed signed by at least two-thirds of the owners within the PID or by the owners of property comprising at least two-thirds of the total area of the PID. *Id.* at Section 372.010.

After all objections have been heard and the governing body has passed on the objections, the governing body by ordinance or order shall levy the assessment as a special assessment on the property, and shall specify the method of payment of the assessment. The installments must be sufficient to meet annual costs for improvements and must continue for a period necessary to retire the indebtedness on the improvements. *Id.* at Section 372.017. Interest may be charged and delinquent installments of the assessment shall incur interest, penalties, and attorney's fees in the same manner as delinquent ad valorem taxes. *Id.* at Section 372.018. The statute provides specific provisions regarding the issuance of general obligation and revenue bonds. *Id.* at Section 372.024. A PID may be dissolved in the same manner as it was created by petition; however, the PID shall remain in effect for the purpose of paying any obligations of indebtedness for improvements. *Id.* at Section 372.011.

A PID provides a valuable mechanism to assess the actual cost of the improvement directly on the property that will benefit most from the improvement, and not charge the entire community. In addition the PID may be created within the city limits or in the city's ETJ. *Id.* at Section 372.003. The Attorney General has concluded that the assessments from a PID may be used to construct an improvement on private property so long as the city retains enough control over the project to ensure the public purpose is accomplished and protected. Op. Tex. Gen. No. GA-0528 (2007).

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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