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Administration of Public Improvement Districts and Tax Increment Reinvestment Zones

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I. PUBLIC IMPROVEMENT DISTRICTS

A. Introduction

Chapter 372, Texas Local Government Code, grants to the governing body of a municipality the power to establish a public improvement district (“PID”) within its corporate boundaries or within its extraterritorial jurisdiction, upon its own initiative or upon receipt of a petition requesting the establishment of a PID. If the governing body of a municipality finds that an improvement project promotes the interests of the municipality, the governing body may undertake an improvement project that confers a special benefit on a definable part of the municipality or the municipality’s extraterritorial jurisdiction through the establishment of a PID.

The costs of the improvements may be paid through the levy of assessments on the benefited property. The apportionment of costs must be made based on special benefits accruing to the property because of the improvement and documented in a Service and Assessment Plan (“SAP”) that is updated annually. Additionally, a municipality may issue bonds secured by the payment of annual installments of assessments to pay for the costs of an improvement project.

B. Improvements

A city may undertake an improvement project that confers a special benefit on a definable part of the city or the city’s extraterritorial jurisdiction.

Practice Tip: The city should calculate the impact of the maintenance of these public improvement projects and/or the population increase associated with the public improvement project on the city’s budget commiserate with the financing of any items 1-10 listed below.

A public improvement project may include:

1. Landscaping;
2. Fountains, distinctive lighting, and signs;
3. Sidewalks or streets, any other roadways, or their rights-of-way;
4. Pedestrian malls;
5. Pieces of art;
6. Libraries;
7. Off-street parking facilities;
8. Mass transportation facilities;
9. Water, wastewater, or drainage facilities or improvements;
10. Parks;

11. Projects similar to those listed above;
12. Acquisition, by purchase or otherwise, of real property in connection with an authorized improvement;
13. Special supplemental services for improvement and promotion of the district, including services relating to advertising, promotion, health and sanitation, water and wastewater, public safety, security, business recruitment, development, recreation, and cultural enhancement;
14. Payment of expenses incurred in the establishment, administration, and operation of the district; and
15. Affordable housing.¹

C. Service and Assessment Plan

The advisory body, or if no advisory board, city staff or a plan administrator, must prepare an ongoing service plan and present the plan to the governing body of the municipality for review and approval. The plan must cover a period of at least five years and must also define the annual indebtedness and the projected costs for improvements.² The plan shall be reviewed and updated annually for the purpose of determining the annual budget for improvements. An assessment plan must be included in the annual service plan.³

Practice Tip: The SAP is the City's plan. It may not be in the city's best interest to allow the developer and/or its consultant to draft the SAP and/or annual update thereto.

Contents of SAP includes:

1. Property included in the PID;
2. Public improvements and projected costs;
3. Assessment plan (benefits, allocation of costs)
 - a. Assessment methodology must result in imposing equal share of costs on property similarly benefitted;⁴ and
 - b. allocations of costs for improvements that benefit the PID and the city as a whole. Examples include utility capacity expansions, pools and parks. Financing of costs allocated to the city or property owners outside of PID;
4. Service plan (sources and uses of funds);
5. Annual indebtedness;
6. Assessment roll;
7. Ownership and management of public improvements; and

¹ Section 372.003, Tex. Loc. Gov't Code.

² Section 372.013, Tex. Loc. Gov't Code.

³ Section 372.014, Tex. Loc. Gov't Code.

⁴ Section 372.015(b), Tex. Loc. Gov't Code.

8. Dedicated, conveyed, leased or otherwise provided for the benefit of a city, a county, or other political subdivision.⁵

Practice Tip: If tax-exempt bonds are issued, any private entity that manages an improvement for a fee is considered private use and may require the city and the private entity to enter into qualified management contract to maintain tax-exempt status of the bonds. 501c-3 entities, including HOAs and water supply corporations, are private entities.

D. Administration of PIDs

1. Update SAP at least annually⁶

Practice Tip: The Annual SAP Update should be provided to the City Staff, City Financial Advisor, Bond Counsel, and City Attorney, for review well in advance of placing on the Council Agenda for approval.

- a. Update costs of improvements and total budget;

Practice Tip: Obtain updated budget numbers from developer well in advance of city council approval of update to SAP. Provide form spreadsheets that conform to the presentation of costs and budget in SAP.

- b. Update five-year service plan, including projected costs and annual indebtedness;

- c. Update assessment roll:

- i. interlocal agreement with County Tax Assessor-Collector⁷;
- ii. due to County Tax Assessor-Collector generally before September 1;

- d. Certain County Tax Assessor-Collectors do not have the software to include assessments on tax bills; and

Practice Tip: For new parcels or lots, assessment rolls must reflect the collection agency's identification methodology.

- e. Update installment schedule and interest rate upon issuance of bonds.

2. Collection of Assessments

- a. Prepare and send assessment roll to Tax Assessor-Collector;
- b. Record assessment payments received;
- c. Track delinquent assessments; and
- d. Prepare deposit certificates for city depository or bond trustee.

Practice Tip: The Public Finance Division of the Texas Attorney General's office deems an assessment levy "stale" if it is not collected within two years of the assessment levy, unless proper procedures under Chapter 372 are followed for deferring the collection of the assessments.⁸

⁵ Section 373.023(a), Tex. Loc. Gov't Code.

⁶ Section 372.013(b), Tex. Loc. Gov't Code.

⁷ Section 372.0175, Tex. Loc. Gov't Code.

⁸ Sections 372.0055 and 372.017(b), Tex. Loc. Gov't Code.

3. Allocating of cost and assessments upon subdivision or final plat
 - a. Methodology and allocation procedures documented in SAP

Practice Tip: Ensure that original SAP identifies the methodology and allocation procedures, and that any future Annual SAP Update is not submitted that arbitrarily changes those procedures without input from bond counsel to ensure compliance with state and federal law.
 - b. If developer rezones a parcel or lot counts differ from original SAP could trigger state law and federal tax law issues
 - i. Under state law assessments must be levied on the basis of special benefits accruing to the property because of the improvements.
 - ii. If tax-exempt PID Bonds were issued, Internal Revenue Code requires that assessments are:
 - A. imposed pursuant to a state law of general application that can be applied equally
 - B. repaid on an equal basis⁹
 - c. True up provisions so that maximum assessment is not exceeded

Example: If the subdivision of any assessed property by a final subdivision plat causes the special assessment per lot for any lot type to exceed the maximum assessment, the owner must prepay the portion of the assessment for each assessed property that exceeds the maximum assessment in an amount sufficient to reduce the assessment to the maximum assessment.
 - d. Mandatory prepayment if property is no longer benefiting from improvements

Practice Tip: Independent School Districts are subject to repayment of the assessment only by contract,¹⁰ even if property is sold to an ISD after the levy. Identifying such property prior to the levy is most beneficial to both the city and the developer.
4. Payment Requests
 - a. Cost of improvement may be paid from the following:
 - i. The proceeds of bonds, temporary notes or time warrants; and
 - ii. Assessment revenues pursuant to an installment sale contract or reimbursement agreement
 - b. Determine if costs submitted are qualified improvement costs

Practice Tip: A city cannot enter into a reimbursement agreement with a developer until the 21st day following publication of resolution creating the PID.¹¹ If improvements were constructed prior to entering into reimbursement agreement,

⁹ Treas. Reg. 1.141-5(d).

¹⁰ Section 372.014(b), Texas Local Government Code.

¹¹ Section 372.010(c), Texas Local Government Code.

the city cannot acquire improvements that have already been accepted by the city.¹²

- c. Review controlling agreements, such as financing agreement or reimbursement agreement for backup that must be submitted with each payment request. Backup generally includes the following:
 - i. A certification/request for payment executed by the project engineer and construction manager specifying the amount of work that has been performed and the cost thereof;
 - ii. An affidavit from the contractor stating that it has paid each person in full for all labor and materials used in the construction of the applicable improvement (a "Bills Paid Affidavit");
 - iii. Copies of all supporting invoices with respect to such payment;
 - iv. Cancelled checks;
 - v. Waivers of liens for work on the applicable improvements through the previous certification/request for payment and receipts for payment from the contractor;
 - vi. City inspector report/sign-off; and
 - vii. If final payment, maintenance bond and warranties.

Practice Tip: Due to the nature of the allocation of costs, the city should control the accounting for the various dollars identified in the certification/request for payment made by the developer. Typically, the certificate/request for payment allows the city 10-15 days to review all the documentation and prepare a response.

- d. Save payment records until final maturity of the bonds, plus 3 years.

5. Notice to residential homebuyer

- a. Texas Property Code requires the seller of residential real property located in a PID to give to purchaser of the real property a written notice that reads substantially similar to the following:

NOTICE OF OBLIGATION TO PAY PUBLIC IMPROVEMENT DISTRICT ASSESSMENT TO (*municipality or county levying assessment*) CONCERNING THE PROPERTY AT (*street address*)

As a purchaser of this parcel of real property you are obligated to pay an assessment to a municipality or county for an improvement project undertaken by a public improvement district under Subchapter A, Chapter 372, Local Government Code, or Chapter 382, Local Government Code. The assessment may be due annually or in periodic installments. More information concerning the amount of the assessment and the due dates of that assessment may be obtained from the municipality or county levying the assessment. The amount of the assessments is subject to

¹² Attorney Genal All Bond Counsel Letter dated December 17, 2008.

change. Your failure to pay the assessments could result in a lien on and the foreclosure of your property.

Date: _____
Signature of Purchaser¹³

- b. Homebuyer disclosure program
 - i. Form of homebuyer disclosure should be appendix to SAP, including assessment and amortization schedule;
 - ii. Developer/homebuilder to include in materials provided to potential homebuyers; and
 - iii. Only city can enforce homebuyer disclosure program.

Practice Tip: Homebuyer disclosures should also include clarification that PID assessments are not property taxes, and certain individuals, such as disabled veterans or over 65 exceptions still must make assessment payments which typically appear on property tax statements.

- 6. If landowner prepays assessment in full, prepare lien release for city attorney to file in public records and mail to homeowner.
- 7. If bonds were publicly offered, assist with preparing reports for continuing disclosure undertakings of city and developer pursuant to SEC Rule 15c2-12.
 - a. DO NOT miss a filing deadline. The SEC takes meeting your deadlines very seriously.
 - b. In advance of each developer quarterly filing, provide forms or excel spreadsheets covering contents of report to developer.

Practice Tip: Review the developer's quarterly filing, even if provided on the city's form. Attention to detail, as well as meeting SEC deadlines are critical to the entire PID Administration process.

II. TAX INCREMENT REINVESTMENT ZONE

A. Introduction

Tax Increment Reinvestment Zone ("TIRZ") refers to the designated geographic area created under Chapter 311, Texas Tax Code. A TIRZ is a separate political subdivision and is governed by its own board of directors. Incremental tax revenues generated within a TIRZ are used to pay the costs of the public improvements. The incremental tax revenue received from the properties within the TIRZ is referred to as the "tax increment." Each taxing unit within the TIRZ can choose to dedicate all, a portion, or none of its tax increment.

"Project Costs" are the expenditures made or estimated to be made and monetary obligations incurred or estimated to be incurred by the reinvestment zone that are listed in the project plan as the costs of public works, public improvements, programs, or other projects benefiting the TIRZ, including other costs

¹³ Section 5.014, Tex. Prop. Code.

incidental to those expenditures and obligations. Project Costs may be paid through the collection of tax increment revenues paid to the tax increment fund.¹⁴

B. Improvements

A city may acquire, construct, reconstruct, or install public works, facilities, or sites or other public improvements, including utilities, streets, street lights, water and sewer facilities, pedestrian malls and walkways, parks, flood and drainage facilities, or parking facilities, but not including educational facilities listed in the Project Plans.¹⁵

C. Project Plans

1. Preliminary Plans

Practice Tip: The Preliminary Project and Finance Plan should not be the first step in discussing a TIRZ with the city council or any other taxing entity that might participate. Discussion of projects that are mutually beneficial to all entities can help align the Project Plan components.

If an area qualifies as a TIRZ, the City must prepare a preliminary reinvestment zone financing plan, which should include:

- a. A detailed list of project costs of the zone;
- b. A statement listing the kind, number and location of all public works or public improvements to be financed by the zone;
- c. A finding that the plan is economically feasible and an economic feasibility study;
- d. The estimated amount of bonded indebtedness to be incurred;
- e. The estimated time when related costs or monetary obligations are to be incurred;
- f. A description of the methods for financing project costs and the expected sources of revenue to finance or pay project costs, including the percentage of tax increment to be derived from the property taxes of each taxing unit anticipated to contribute tax increment to the zone;
- g. The current total appraised value of taxable real property in the zone;
- h. The estimated captured appraised value of the zone during each year of its existence; and
- i. The duration of the zone.¹⁶

The City should also create a preliminary project plan, which should contain:

- a. A description and map showing existing uses of real property within the zone and any proposed improvements;
- b. Any proposed changes to zoning ordinances, the master plan of the city, building codes, or other municipal ordinances;

¹⁴ Section 311.002(1), Tex. Tax Code.

¹⁵ Section 311.008(b)(4), Tex. Tax Code.

¹⁶ Section 311.011(c), Texas Tax Code.

- c. A list of estimated non-project costs; and
- d. A statement of the method for relocating persons who will be displaced as a result of implementation of the plan.¹⁷

Practice Tip: Non-project costs should include a City's estimated cost of service associated with the improvements and a quantified net benefit or cost to the City. Commercial AND residential uses should be included in this calculation and estimated sales tax should be included in the cost benefit revenue stream. Engaging professional help to fully analyze this cost/benefit equation and presenting it to the various entities can make this process much more productive and less time consuming on City administrative personnel.

D. Final Plans

The Board of Directors must prepare both a final project plan and a final reinvestment zone financing plan and submit the plans to the governing body of the city. Both plans are required to include the same provisions as the preliminary plans. The city must approve the plans by ordinance, which must include a finding that the plan is feasible. *Practice Tip:* Cities frequently design TIRZ projects to assume County and other taxing district participation. These negotiations can be lengthy and arduous if the City and other taxing entities have not considered the cost/benefit of the TIRZ for all entities. The City oftentimes takes the lead in providing these analyses to the taxing entities if requested and be prepared to assist these entities in any way possible to obtain their consent to participate. Be aware that not every entity will agree to the same participation rate as the City, so care should be taken in differentiating these participation rates in advance of finalizing a Final Plan.

Practice Tip: The statute allows the TIRZ to be amended under certain conditions and following certain procedures. It is not uncommon that TIRZ boundaries be expanded to take in new development that provides a mutual benefit to the City and the participating entities. Each entity must independently consider any amendment to the TIRZ following a review and recommendation by the TIRZ Board.

1. Agreements

The Board of a TIRZ and the city that creates a TIRZ may each enter into agreements to implement the project plan and reinvestment zone financing plan and achieve their purposes. An agreement may during the term of the agreement dedicate, pledge, or otherwise provide for the use of revenue in the tax increment fund to pay any project costs that benefit the TIRZ.

Practice Tip: Participation Agreements between the city and other participating taxing entities is critical to properly providing documentation to the collecting agency for the allocation of appropriate TIRZ revenues.

E. Administration of TIRZ

1. Annual Status Report

On or before the 150th day following the end of the fiscal year of the municipality, the governing body of a municipality must submit to the chief executive officer of each taxing unit that levies property taxes on real property in a reinvestment zone a report on the status of the zone. The report must include:

- a. The amount and source of revenue in the tax increment fund established for the zone;

¹⁷ Section 311.001(b), Texas Tax Code.

- b. The amount and purpose of expenditures from the fund;
- c. The amount of principal and interest due on outstanding bonded indebtedness;
- d. The tax increment base and current captured appraised value retained by the zone; and
- e. The captured appraised value shared by the municipality or county and other taxing units, the total amount of tax increments received, and any additional information necessary to demonstrate compliance with the tax increment financing plan adopted by the governing body of the municipality or county.¹⁸

The city must also send a copy of a report made under this section to the comptroller.

III. PUBLIC IMPROVEMENT DISTRICT WITH TAX INCREMENT REINVESTMENT ZONE OVERLAY

A. Under certain facts and circumstances a city may desire to create a PID with a TIRZ overlay. To the extent that assessment revenues generated by the PID are not sufficient to fully reimburse a developer, all or a percentage of the TIRZ revenues may be used to finance additional improvement costs.

Practice Tip: It is not advisable for the city to agree to a percentage of TIRZ credit in ancillary agreements until the TIRZ preliminary project and finance plan, and the PID service and assessment plan basic financial details have been created and reviewed by the city.

- 1. Annual cash flow basis pursuant to a reimbursement agreement with a developer.
- 2. Annual credit against assessment portion of annual installment of assessments:
 - a. TIRZ revenues must be allocated on a lot by lot basis;
 - b. TIRZ revenues are deposited with trustee under bond indenture thereby reducing the assessment portion of the annual installment; and
 - c. Delay in application of TIRZ Revenues as credit.

Practice Tip: City should discuss with its financial advisor the financial impact on the city's budget resulting from the loss of ad valorem tax revenues.

The facts and circumstances for creating each PID and TIRZ is unique, therefore, this outline of the duties and responsibilities of a city in administering a PID and/or a TIRZ is not intended to be a complete compilation of such duties and responsibilities.

¹⁸ Section 311.016, Texas Tax Code.