



ATTORNEY GENERAL OF TEXAS
GREG ABBOTT

December 17, 2008

To All Bond Counsel:

Re: Proposed Public Improvement District Guidelines; Public Finance Division
Personnel; Proposed Public Finance Division Rules

1. **Proposed Public Improvement District Guidelines.** Efforts to finance improvements in public improvement districts ("PIDs") implicate a number of currently unsettled legal and/or administrative issues. The Public Finance Division receives numerous inquiries from bond counsel each year regarding the validity of proposed PID financing structures. We believe that the development of a more comprehensive framework for considering PID financings would help issuers and bond counsel avoid unnecessary delays in or uncertainty regarding the legal requirements for the issuance of PID bonds.

Attached as Exhibit A are proposed guidelines regarding the issuance of PID bonds under Subchapter A, Chapter 372, Texas Government Code (the "Act"). In developing the proposed guidelines, we engaged in extensive discussions with bond counsel firms that frequently represent issuers of PID bonds. While additional legislation may be necessary to achieve some of the goals expressed by bond counsel, we believe the proposed guidelines address most of the issues raised in the course of our discussions.

Our goal is to develop guidelines that will provide a workable platform for the structuring and review of future PID financings within the parameters of the Act. As a result, prior to formally adopting the guidelines we would like to give all interested parties an opportunity to provide written comments as to the positions expressed in the proposed guidelines. Please submit any written comments to the Public Finance Division no later than January 19, 2009. Comments should be addressed to the attention of Stephanie Leibe.

2. **Public Finance Division Personnel.** Thank you for your support during my tenure in the Public Finance Division. It was a pleasure to have the opportunity to work with the members of the Texas bond community and the outstanding lawyers in the Public Finance Division. Effective December 1, I assumed the duties of Deputy Attorney General for Legal Counsel. I look forward to serving you in this new role.

Tom Griess has graciously agreed to serve as the acting Chief of the Public Finance Division. Tom has been with the Public Finance Division for seventeen years, and during that time he has demonstrated an unparalleled knowledge of state public finance law. A gifted teacher, his service will be an asset to the Texas bond community. Please join me in welcoming him to this new position.

3. Proposed Public Finance Division Rules. Our office remains committed to maintaining an open dialog with the bond community, and your input is a critical element in our efforts to ensure that we efficiently and effectively fulfill our statutory duties. In addition to the proposed PID guidelines being distributed today, the Public Finance Division recently began the process of revising Title 1, Chapter 53 of the Texas Administrative Code. Proposed revisions to Subchapter A of Chapter 53 were distributed to interested parties for informal comment on November 26, 2008. Proposed revisions to other subchapters will follow in the coming months. To the extent you have any suggestions regarding the proposed PID guidelines or rules, we hope you will take the opportunity to submit comments.

Thank you for your cooperation in distributing this information to your colleagues.

Very truly yours,

A handwritten signature in black ink, reading "Jonathan K. Frels". The signature is fluid and cursive, with the first name being the most prominent.

Jonathan K. Frels
Deputy Attorney General for Legal Counsel

Exhibit A -- Proposed Public Improvement District Guidelines

EXHIBIT A

Proposed Public Improvement District Guidelines: Application of Subchapter A, Chapter 372, Texas Local Government Code In Bond Transactions

Note: Throughout this document we have used the term city as shorthand for municipality or county unless context requires otherwise, as with the discussion related to §49.108 contracts.

I. Boundaries and Composition of PID

- A. Contiguity: The land within the boundaries of a PID must be contiguous. According to JM-295, when a statute is silent as to a contiguity requirement, then the statute is presumed to require contiguous land.
- B. City Owned Land: Land owned by a city that is exempt from *ad valorem* taxes should not be considered when calculating the ownership of land in a PID for petition purposes.

II. Notice

- A. City Official Action: A city must take official action in order to authorize the giving of §372.009 notices. This is the same requirement as is in place for authorizing the publication of CO notices of intent.
- B. Description of Boundaries: PID boundaries may be described in a PID notice by reference to existing streets and roads, with the notice indicating that the metes and bounds are on file and available for inspection.

III. Projects Outside of the PID/No Assessment of Areas Outside of a PID

- A. Projects Outside of a PID: Section 372.003(a) provides implied authority for a PID to construct improvements outside of the PID and to levy assessments against the landowners in the PID so long as the improvements confer a *special benefit* on the landowners in the PID, the project is located within the city limits or the extraterritorial jurisdiction of the city, and the city finds that the improvement project promotes the interests of the city. Section 372.003(a) does not appear to provide any authority for undertaking projects outside of a city's extraterritorial jurisdiction. See *Hope v. Village of Laguna Vista*, 721 S.W.2d 463 (Tex.App. – Corpus Christi 1986, writ ref'd n.r.e.). See also section VI.E. for information regarding special benefits determinations.

- B. No Assessment of Areas Outside of a PID: Chapter 372 does not allow a city or a county to levy an assessment against property located outside of a PID. Section 372.012, which is entitled "Area of a District," provides for creating a PID in an area that is smaller than that contained in the notice. It also provides a mechanism for increasing the area within the proposed boundaries of the PID. Given the context of the provision, the explicit reference to §372.009, and due process considerations, §372.012 cannot be read to provide for the assessment of areas outside of a PID.

IV. Phasing

- A. Levy of Assessments Prior to the Issuance of Bonds: Section 372.023(d) provides that "a cost payable from a special assessment that is to be paid in installments . . . shall be payable from the issuance and sale of revenue or general obligation bonds."

1. In order to levy assessments in installments, a PID must issue bonds.
2. A reasonable time period may elapse between the levy of the assessment and the issuance of bonds in order to allow for improvements to be completed and bonds to be marketed. The time period is not intended to allow for phasing, which should be covered by multiple assessments as discussed below. The maximum time period between the levy of the assessment and the sale of the bonds is two years. The initial levy should be for the principal amount of the improvements to be covered in the phase plus interest on the principal amount at a reasonable not to exceed rate. The assessments should be structured to expire if bonds are not issued or the improvements are not constructed.

- B. Multiple Assessment Levies to Accommodate Phases of Development:

1. A PID may make multiple assessments on property in a PID in order to facilitate new phases of a project so long as the procedural requirements in Chapter 372 for imposing assessments are followed. The procedural provisions that must be followed are §§372.013 through 372.018. In order to provide for phasing, the actions of the city creating the PID (§§372.005 through 372.010) must contemplate all of the improvements to be included in all subsequent phases. As a result, the city should include all of the projects it is considering as part of the phasing plan as part of its resolution and the service and assessment plan. See §§ 372.006(b), 372.013 and 372.014. Phrases such as "and any other

improvements allowed by law” are overly inclusive and do not give appropriate notice to property owners. As a result, the use of such phrases to describe the proposed improvements is not acceptable.

2. Application of Principles: The following describes the application of these principles in a raw land development with master facilities and phases of development.

a. Master Facilities: The city would levy against all of the property within the PID for improvements benefiting the entire PID.

b. Each Phase: The PID would follow the procedures in §§372.013-372.018 in adopting a service plan and levying assessments for each phase of the work.

c. This procedure would provide an orderly approach to the assessment of land in a multi-phase development, and it would prevent the over-assessment of property and contingent assessments of property that would remain outstanding for extended periods of time, creating a cloud on the title to such property. If master facilities and the first phase (or multiple phases) of development are being financed at the same time, a single series of PID assessment bonds could be issued for such improvements. If an issuer is issuing combination contract revenue and PID assessment bonds for such purposes, the issuer must comply with the principles described in Section VII, below.

C. Reimbursement of Developers: Chapter 372 does not allow for the reimbursement of developers or payments by a city for the acquisition of improvements already dedicated to the city. However, it is a permissible use of bond proceeds for the city to reimburse itself for costs incurred in the establishment of the PID.

V. **Assessment Levies**

A. Levies based upon Estimates: Sections 372.016 and 372.017 provide that assessments shall be levied after the total cost of the improvements is determined. Assessments may be based upon reasonable estimates contained in an official report (e.g. an engineer’s report). Such levies may be based upon (i) an estimate containing a breakdown for each individual cost or (ii) an estimate containing a cost breakdown by categories of expenditures. If a levy is based upon an estimate, the levy must be

structured so that the levy may be reduced in the event that the actual costs are less than the estimate.

- B. Annual Installments: Annual installments need not be level.
- C. Interest on Assessments: Section 372.018 authorizes cities to collect assessments that are one-half of one percent above the actual interest rate on the bonds used to finance improvements. While the statute does not expressly provide a use of these funds, a reasonable construction of the statute would allow such amounts to be used for debt service reserves, administrative expenses, and in certain circumstances, project costs of the PID. Estimates (presumably for each phase) should be sufficient to cover the costs of the proposed improvements (for that phase). If an assessment is based upon an estimate, the levy should be for the full amount of the estimate with the ability to downsize if the costs of the improvements come in under the estimates.
- D. Prepayment: Section 372.018(b) provides that a landowner must be able to pay, at any time, the entire assessment, *with interest that has accrued on the assessment*, on any lot or parcel. This language does not allow a PID to charge landowners who are prepaying their assessments an additional amount of money that would cover the interest that would accrue between the time of prepayment and the redemption date on the bonds. The debt service reserve fund is a more appropriate source of funds.
- E. Filing: In order to ensure that future property owners have notice of the lien on their property and to help ensure that payments will be made, the city should provide evidence that the assessment roles have been filed in the county deed records. See TEX. PROP. CODE §5.014.
- F. Findings Regarding the Ability to Repay: In the assessment order or ordinance, a city or county must include a recital stating how the amounts of the assessments was determined (§372.015), and a finding that such assessments are in amounts necessary to meet the annual costs of improvements and will continue for the period of time necessary to retire the indebtedness on the improvements (§372.017).
- G. Adjustments of the Principal Amount of Assessments: Apportionments must be based upon the special benefits accruing to a property owner because of an improvement (§372.015(a)). In order to ensure that property owners are not subject to unchecked expansions in project scope and costs, the principal amount of an assessment for a particular project may be adjusted downward under §372.015(d), but not increased. Additional assessments may be made for improvements included in the city's §372.006 findings when creating the PID by following the

procedures set forth in §§372.013 through 372.018, in the same manner as set forth for phasing. Interest amounts and collection costs may be increased or decreased. Interest expenses and collection costs are treated separately under § 372.018, and should be subject to greater adjustment than principal amounts in order to prevent over collection for those costs, which tend to be variable in nature.

- H. Payments of Assessments By Cities and Counties: Section 372.014(b) states that a municipality or county is responsible for payment of assessments against exempt municipal or county property within a PID. This responsibility for paying costs may not be simply reapportioned among the other property owners in the PID. To the extent that a city does not want to levy an assessment against municipal property, it would be acceptable for a city to take the value of its assessment liability into account when making an apportionment under §372.006. When apportioning the costs under §372.006, the city must specify the specific improvements that will be the responsibility of the city and/or either a dollar amount or percentage of the costs for the improvements which will be paid by the city. It is not sufficient to only indicate that the city will bear a portion of the costs.

VI. Authorized Projects

- A. Open Space: PID Bonds may be issued for open space under the theory that Section 372.003(b)(10) and (11) authorize park improvements and other similar improvements.
- B. "Projects Similar" Language: The rule of *ejusdem generis* provides that where general words follow an enumeration of things, such general words are not to be construed in their widest extent, but are to be held to apply to only things of the same general kind or class of those specifically named. As a result, we read Section 372.003 (11) to limit the items that may be financed under Chapter 372 to items that are of the same general character of those specifically named.
- C. Acquisition of Existing Improvements: Section 372.010(c) states that actual construction of an improvement may not begin until after the 20th day after the date the authorization takes effect (the publication of the city resolution). An acquisition of existing property may not take place until after the 20th day after the effective date of the authorization. If construction on a project starts before the 20th day after the effective date of the authorization, the project will have to be acquired as if it was an existing improvement, after construction is complete. There may be circumstances under which a city could purchase a project under construction. However, the city would need to ensure that, among other things, it followed the applicable procurement laws, obtained

protection from the seller for costs overruns, and could reasonably ascertain the value of the improvements and the contract it sought to acquire.

- D. Firefighting Equipment: Expenditures for firefighting equipment to serve the PID are authorized under §372.003(a)(13), which authorizes projects for special supplemental services, including public safety.
- E. Facilities of General Municipal Benefit/Regional Facilities: The costs of a facility that has a general municipal benefit or regional benefit should not be solely borne by the property owners in the PID. Section 372.015 states that PID assessments must be based upon the *special benefits* accruing to the property owners. Further, §372.006 provides that the costs of improvements should be apportioned between the PID and the municipality or county as a whole. To the extent that it cannot be said that a particular tract of property is receiving a special benefit that is different than that accruing to the city as a whole, those costs should be borne by the city and not the property owners in the PID. The Texas Supreme Court has stated

. . . it is clear that the term "special benefit" connotes an enhancement more localized than a general improvement in community welfare, but not necessarily unique to a particular piece of property. A special benefit is one going beyond the general benefit supposed to diffuse itself from the improvement through the municipality.

Haynes v. City of Abilene, 659 S.W.2d 638, 641-642 (Tex. 1983). The Court further stated

Special benefit is not merely a creature of statute. Both our state and federal constitutions limit special assessments to the amount of benefit conferred on the property assessed. An assessment against property and its owner . . . on any basis other than for benefits conferred and in an amount materially greater than the benefits conferred violates Section 17 of Article 1 of the Constitution of Texas, which prohibits the taking of private property for public use without just compensation.

Id at 641. A violation of these principles may render an assessment void and unenforceable. *Id* at 642. Given the fact that the special benefits finding implicates state and federal constitutional concerns and not simply state law concerns, the city should carefully consider the projects financed through PID assessments. Section 372.003(a) also suggests that general municipal improvements may not be appropriate. It only authorizes improvement projects that confer a special benefit on a definable part of a municipality.

VII. Combination Contract Revenue and PID Assessment Bonds

A. Basic Principles regarding Joint Utilities Contracts between a Water District and a City

1. Water districts can only make contract payments under Section 49.108 of the Water Code for projects the district is authorized to undertake.
2. To the extent that a city and a water district are both authorized to undertake a project, the district may make contract payments and the city may pledge assessments.
3. To the extent only the city is authorized to undertake a project, only assessments or assessments combined with another authorized city revenue source would be acceptable.
4. If a water district levies an Art. III, Sec. 52 tax for projects, the tax revenues may only be used for Art. III, Sec. 52 authorized purposes.
5. If a water district levies an Art. XVI, Sec. 59 tax for projects, the taxes can only be used for Art. XVI, Sec. 59 authorized purposes.
6. The PFD has traditionally not allowed water districts to issue bonds for water and sewer purposes (Art. XVI, Sec. 59) and road purposes (Art. III, Sec. 52) in a single series, as different maturities would be secured by different taxes.
7. Art. XVI, Sec. 59(c) (majority vote) and Art. III, Sec. 52(b) (2/3 vote) require that indebtedness of a district be voted. It is from this authorized indebtedness that the district obtains its unlimited taxing power. As a result, it is necessary for the contracts to contain the principal amount of the bonds to be supported by a contract tax voted under each constitutional provision.

B. Application of the Principles

1. District contract elections must clearly identify the constitutional provisions pursuant to which a District is voting a contract tax.
2. There should be separate contracts for Art. XVI, Sec. 59 projects and Art. III, Sec. 52 projects, and each contract should be voted in its own proposition.

12/1/2008 DRAFT: FOR DISCUSSION PURPOSES ONLY

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3. A contract must contain the principal amount of the obligation being voted under the contract.
4. A substantially complete version of the contract to be approved by the voters, including a description of the improvements and the service area, the maximum amount of the potential expenditures under the contract, and the constitutional authorization for the contract, must be attached as an exhibit to the order calling the election. Additionally, if the contract contains more than one participant, the contract should also identify the additional participants and show an allocation of costs between the participants.
5. There should be separate series of bonds associated with each contract.
6. See the following section for a discussion of the need for assessments to be levied and collected in connection with the issuance of combination contract tax and assessment bonds.

VIII. Revenue Bonds: Assessments/Contract Revenues/TIF Revenues

- A. Section 372.026(d) authorizes a governing body to pledge to the payment of bonds all or a portion of any revenues received by the governing body with some limitations. In addition, Section 1371.103(a) also authorizes certain qualifying issuers to pledge any revenues that an issuer is authorized to pledge to the payment of an obligation.

1. Basic Principles:

- a. The bonds must have uniform security.
- b. Section 372.018(b) provides that a landowner must be able to pay, at any time, the entire assessment, with interest that has accrued on the assessment, on any lot or parcel. If assessments are levied for the full amount and *ad valorem* taxes are used to pay the bonds and “buy down” the assessments (as is possible in certain scenarios involving §49.108 contracts), then the right to prepay an assessment on a piece of property is not a real right since the property owner would continue to pay taxes on the same improvements after paying off the assessments. Essentially, a landowner would be paying for the improvements twice if they decided to exercise the prepayment right.

- c. All revenues pledged to the same series of bonds must be eligible to be spent on all of the projects financed with the bonds.
- d. The provisions of Chapter 372 contemplate that an assessment will be levied and collected in connection with improvements financed under Chapter 372, Subchapter A and Chapter 372 currently provides the only authority for a city to issue bonds secured by contract revenues. Further, unless an assessment is levied and collected for payment of all or a portion of the bonds or improvements to be financed through combination contract revenue and assessment bonds involving a §49.108 contract, the ability to pay all of the debt service from the water district taxes suggests that the arrangement is simply a mechanism for avoiding TCEQ oversight and increasing the amount of payments that may be made to a developer. Such an arrangement would constitute an abusive use of Chapter 372. SEE ATT'Y GEN. OP. NO. JC-0092 (1999) at 6.
- e. Section 372.026(d) arguably refers only to revenues received from a third party, which would allow the pledge of revenues received under a contract or a grant, but not TIF revenues or general revenues of the city, unless a city is a 1371 issuer. Further, §§ 372.024 and 372.026(a) provide that revenue bonds are to be payable from and secured by liens on "all or part of the revenue derived from improvements authorized under this subchapter, including revenue derived from installment payments of special assessments." This provision arguably provides a further limitation on the use of certain other revenues of the city.

2. Application of Principles:

- a. For combination contract revenue (§49.108) and assessment bonds, an assessment must be levied for some percentage of the project amount. The contract tax may then be used for the remaining percentage for the contract amount. The security would be described so that it applies equally to all bonds. The bond structure would have to contain a mechanism for requiring the redemption of bonds upon the prepayment of assessments by a landowner.
- b. For combination revenue (e.g. TIF revenues) and special assessment bonds, there is an argument for allowing an

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assessment be levied for the full amount of the bonds, and, to the extent that the bonds are paid from TIF revenues, allow the assessments to be bought down on an annual basis. The PID would have to update the assessment role each year in order to ensure that it reflects the current status of the assessments. Arguably, §372.015(d) and §372.020(2) provide authority for such adjustments. This arrangement does not implicate the same concerns that are involved in the §49.108 contract context, as there is not a tax levied for the payment of the bonds. The windfall from growth in the TIRZ would produce the revenues for any payments made toward the debt service rather than there being an affirmative decision by a MUD board to levy a tax at a certain level to pay the debt service on the bonds. As a result, there is not the same concern about people overpaying for the release of the assessment from their property. If they made a choice to prepay their assessments, they would simply be foregoing the possibility that growth in the TIRZ could reduce the amount of their assessments in the future. Arguably, the City would only be able to make a pledge of this nature using its Chapter 1371 powers.

IX. Temporary Notes

- A. Section 372.023 authorizes the issuance of temporary notes while an improvement is in progress. We have some concern with respect to the installment payment/assessment requirements of Section 372.023(d) when issuing temporary notes. If properly structured, it may be permissible to issue a BAN payable upon maturity, or prior optional redemption, with revenue bond proceeds.

X. Refunding Bonds

- A. Apportionment of Savings: Any savings from a refunding of PID assessment bonds would have to be passed along to the property owners, as the cost of the improvements would be reduced by the amount of the savings. The savings should be reflected in the annual service plan and the assessments levied against property in the PID. See §372.013 through §372.015.