SPECIAL DISTRICT PLANNING AND FINANCING

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Overview

Types of Special Districts

Issues to be Considered

PID/MUD/MMD Comparison

Creation of a TIRZ for financing City Contributions

PID/TIRZ

Negotiating Development Agreements
Types of Special Districts

• Water Code – (MUDs, FWSDs, WCIDs)
• Municipal Management Districts – (MMDs)
• Created by Legislation – (MUDs, FWSDs, WCIDs and MMDs)
• Public Improvement Districts – (PIDs)
• Tax Increment Reinvestment Zones, Tax Increment Financing – (TIRZs, TIFs)
Issues to Consider

• Existing taxes or assessments
• New taxes or assessments
• Reimbursement Funding
• Undeveloped Land (Raw Land) Funding
• What will be financially successful and competitive and provide enhanced benefits and necessary on-site and off-site infrastructure
What is a PID?

• A PID is a special purpose district created under TLGC Chapter 372.

• Contiguous area of land created by Petition of land owner to a City or County.

• Within the area of land, property owners pay a special assessment for improvements in the area.

• A PID is not a political subdivision
MUDs

- Created by petition to TCEQ; Can be legislative
- If in ETJ of a City, must have consent
- Political subdivision
- May issue debt for water, sewer, drainage or roads
- May levy a maintenance and unlimited debt tax
- MUD may issue bonds backed by revenues or ad valorem taxes
- Must receive approval from TCEQ to sell debt; bonds sold at competitive sale; voted by residents of MUD; sold as property develops (first issue once value created)
Difference Between a PID and a MUD

• A PID is created by the City or County and is governed exclusively by the City or County

• The City or County has no legal liability to pay the assessments

• Bonds are sold on a negotiated basis; are not voted; may be sold prior to any development; and are issued by the City or County

• An election is not required to approve PID Bonds
Municipal Management Districts

- Chapter 375, Local Government Code, and Chapter 49, Water Code, as well as the enabling legislation that created it.
- May finance services and improvements through the levy of assessments on commercial property or ad valorem taxes,
- Some Management Districts are able to levy sales and use taxes or hotel occupancy taxes.
- Most Management Districts levy an assessment on commercial property. Generally, assessments cannot be levied on property used for single-family residential purposes.
- Examples
When to Consider a PID

• Provide for public infrastructure without burdening rate payers and tax payers
• Achieve goals of Comprehensive Plan
• Provide for Enhanced Development – amenities and development standards over and above current development code regulations
• Incentive for annexation
Projects – TLGC § 372.003(b)(1)-(14).

- Landscaping or Parks
- Erection of fountains, distinctive lighting, and signs;
- Roadways, streets, sidewalks or other rights of way;
- Construction or improvement of pedestrian malls;
- Acquisition and installation of pieces of Art;
- Libraries, Parking facilities, mass transit facilities, water, wastewater, or drainage;
- Special supplemental services for improvement and promotion of the district;
- Payment of expenses incurred in the establishment, administration and operation of the district; and
- Development, rehabilitation or expansion of affordable housing.
Petition Requirements

- General nature of the proposed improvement;
- Estimated cost of the improvement;
- Boundaries of the proposed assessment district;
- Proposed method of assessment, specify included or excluded classes of assessable property;
- Proposed apportionment of cost between the PID and city or county;
- Proposed management of the district;
- Person signing concurs with the creation of the district; and
- Advisory body may be established to develop and recommend an improvement plan to the city or county. [TLGC § 372.005(a)(1)-(8)]
1. An assessment bond creates a lien upon the land that requires payment by the landowner
2. Assessments will need to be explained to end users, pass-through payor (ongoing disclosure)
3. Debt MAY be deemed on balance sheet by auditors
4. Since the bonds are non-rated, interest rate will most likely exceed political subdivision’s rated bond
5. Relatively new to the State of Texas and there are challenges with on-going administration of the PID
6. Scrutiny by the Underwriter and prospective bondholders during the due diligence process
7. Ongoing, continuing disclosure requirements for large land owners

8. Forces a continued “partnership” between the City and developer or subsequent owners

9. Formation, execution, and ongoing administration will require time and resources

10. Perception in the financing community – the political subdivision actually issues the bonds and approves construction fund draws, which may establish additional scrutiny on the political subdivision

11. Political risk – perception of providing bond financing to a project without voter approval

12. No direct financial obligation to the political subdivision, but still an obligation
   - Creation
   - Administration
   - Enforcement – Collection & Foreclosure
   - Overlapping debt burden
   - Oversight and scrutiny by municipal regulatory agencies
PID Policies

- Limitation on the size
- Limitations on the PID assessment
- Limitations on tax assessment terms
- PID administration
- Financing guidelines
- Bond size and Developer interest
- Criteria for Projects
- Application and Review Process
- Requirements of TLGC Chapter 372
Tax Increment Financing

• Geographic area designated by a city or county pursuant to Chapter 311 of the Texas Tax Code.

• City (and other taxing units that elect to participate) deposits into a tax increment fund all or a portion of the incremental increases in ad valorem tax that result from development within the zone.
Other Funding Sources

• Also, city can by ordinance adopted subsequent to creation of the zone the portion or amount of tax increment generated from municipal sales and use tax attributable to the zone, above the sales tax base, to be deposited into the tax increment fund.

• Money in the tax increment fund is used to pay project costs (historically for public infrastructure) or make “380” economic development grants (new since 2005).
Criteria to Create the Zone

Area must substantially impair growth

– Conditions that endanger life or property;

– Area open or undeveloped and substantially impairs the growth of the city;

– Federally assisted new community. Sec. 311.005(b); or

– Petition by owners of property within the zone.
TIRZ May Not Be Created

• More than 30% of the property in the proposed reinvestment zone (excluding publically owned property) is used for residential purposes, or

• Total appraised value of taxable real property in the proposed reinvestment zone and in the existing zone exceed either:

  City < 100,000 – 50% of the total appraised value of taxable real property within the city and its industrial districts.
Preliminary Reinvestment Zone Financing Plan

- Detailed list of estimated project costs of the zone including administrative expenses
- Project Costs – expenditures estimated or listed in the project plan as the cost of public works, public improvements, programs or other projects benefiting the zone. Includes incidental costs. Can include cost of economic development programs.
Notice and Public Hearing

- 7 days before the public hearing, notice of the Public Hearing published in the newspaper having general circulation in the city or county on the creation of the reinvestment zone.

- Before adopting the ordinance for the reinvestment zone, the city holds the public hearing on the creation of the zone and its benefits to the city.

- After the public hearing, the city may also designate a noncontiguous area in the city limits or ETJ or both as a reinvestment zone and create the Board.
Ordinance Must Include

- Description of the boundaries of the zone
- Designate the Board of Directors
- Effective Date
- Termination Date
- Name for the Zone, Section. 311.004(a)(5)
- Establish the Tax Increment Fund for the Zone
- Required Findings
Project Plan

• Description and map showing existing uses and condition of real property within the zone and uses of the property;
• Proposed changes to land development ordinances;
• List of estimated non-project costs; and
• Relocation plan, if necessary.
Reinvestment Zone Financing Plan

• Estimated project costs, including administrative expenses;
• Public works and public improvements;
• Finding of economic feasibility and feasibility study;
• Estimated amount of Bonded Indebtedness;
• Estimated time when costs or obligations are incurred
• Description of methods of financing;
• Current total appraised value;
• Estimate of the captured appraised value during each year; and
• The duration of the zone.
After zone established by ordinance

- Board recommends the implementation of the Tax Increment Financing to the City Council.
- Board **may not** issue bonds, impose taxes or fees, condemn property, or give final approval to the project plan.
- City must approve any sale or purchase of property.
- The Board or City may enter into development agreements.
- Annual reports to City and Comptroller.
PID/TIRZ DEVELOPMENT

• Create a PID on all or a portion of a TIRZ
• Assess the entire cost of the TIRZ projects against the land in the TIRZ
• Can be used for City Contribution for City’s proportionate share of TIRZ project
• Examples
Questions?
Special Districts Planning and Financing

Emerging Issues from the Underwriter’s perspective
Disclosure

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Emerging Issues From An Underwriter’s Perspective

Topics for Discussion

I. Using Public Improvement Districts

II. To PID Or Not To PID

III. Engaging the Right Team – Risk Mitigation

IV. What Can Be Underwritten Versus What Should Be Underwritten

V. Conduit Financings / Placements / Direct Purchases / Legislative Session / Market Volatility

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Public Improvement Districts (PID) are economic development tools available to cities and counties to fund or maintain public improvements that benefit the area within the PID boundaries. PIDs have been used by cities and counties for residential (and commercial) development in lieu of other special districts (MUDs, FWSDs, WCIDs) to fund roads, water, sewer, and other eligible costs. The following is a partial list of Texas cities that have utilized special assessments for development:

| City of Haslet | Town of Trophy Club | City of Roanoke |
| City of Aubrey | Town of Northlake | City of Forney |
| City of Argyle | City of Lavon | City of Fate |
| City of Hackberry | City of Westlake | Town of Flower Mound |
| City of Leander | City of Horseshoe Bay | City of Lago Vista |
| City of Celina | City of McAllen | City of Coppell |
| City of El Paso | City of Irving | City of Lewisville |
| City of Little Elm | City of Lubbock | City of Waxahachie |
| City of Irving | The Colony | City of Fort Worth |
Emerging Issues From An Underwriter’s Perspective

To PID Or Not To PID

There are several tools available to cities and counties to facilitate development, including but not limited to:

- **Dependent Districts** – Public Improvement Districts, Assessment Districts
  - City / County controls all aspects of the District – more control, more direct risk, less indirect risk
  - Facilitates a **private / public partnership** through an ongoing relationship between issuer and developer / residents
  - City perspective – 1) time consuming, 2) challenging, 3) benefits greater, 4) maximize control, 5) does not burden the general tax base through “subsidy”
  - Developer perspective – 1) challenging, 2) less control, 3) benefits CAN be greater, 4) more costly upfront, but mitigates capital costs in the early stages of development

- **Independent Districts** – Political Subdivisions of the State, Ad Valorem Districts
  - City / County “consents” to District formation – less control, less direct risk, more indirect risk
  - Facilitates a **relationship** through formation process, with little ongoing controls
  - City perspective – 1) less time consuming, 2) less challenging, 3) less benefits, 4) less control
  - Developer perspective – 1) more standard, 2) more control, 3) financial benefits come later

- **Other Tools**
  - Tax Increment Reinvestment Zones – capturing value created to subsidize development
  - 380 Agreements – economic development incentives from annual appropriations
Emerging Issues From An Underwriter’s Perspective

Engaging The Right Team – Risk Mitigation

Despite communications made by some PID professionals, PIDs (and other special districts) create several risks that the City / County must be aware of before entering into a developer’s agreement.

To mitigate these risks, Cities / Counties should do their own diligence AND engage a group of competent professionals experienced with PIDs, and not necessarily the professionals brought to the table by the developer (in addition to obvious conflicts of interest).

**Risks include**, but are not limited to: 1) Political, 2) Rating (Overlapping Debt), 3) Market, 4) Development, 5) Disclosure, 6) Regulatory, 7) Administrative, 8) Enforcement, and 9) Foreclosure risks.

A competent group of independent professionals is the best way to mitigate potential risks to the City. Below identifies various parties that participate with PID financings. The City engages all parties in the “Representing Issuer” column, the Underwriter, and the Trustee.

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<td>City Staff</td>
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<td>Bond Counsel</td>
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<td>Assessment Administrator</td>
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<td>Developer’s Counsel</td>
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<td>Assessment Consultant / FA Engineer</td>
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<td>Market Feasibility Dissemination Agent</td>
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* Engaged by the Issuer.
Emerging Issues From An Underwriter’s Perspective

What Can Be Underwritten Versus What Should Be Underwritten

Cities / Counties are having to determine what they are comfortable issuing. While the development team may try to maximize proceeds by pushing the limits of what can be underwritten, the issuer will need to determine what should be underwritten (and how to be underwritten). Some factors in making that decision includes:

1. Leverage – value to lien – calculation not necessarily derived the same as development / underwriter team
2. Status of Development – is this a “dirt deal” or reimbursement PID
3. Indications of Demand – letters of intent, builder contracts, or do homeowners actually occupy homes
4. Overall Plan of Finance – what is the level/type of fiscal commitment being offered prior to bond issue
5. Developer – is the developer established, reputable with a quality resume
6. Phasing – is this a single phase or does the developer have a multi-phased project
7. Desirability – how important (strategic) is this development to the issuer and what are the benefits

Generally, underwriting criteria on a national level includes:

• Value to Lien – typically 3:1 – though this is determined on a project by project basis
• All public approvals, entitlement, and utility service delivery issues be resolved
• Private sources of funding be fully committed, so that the overall plan of finance (bonds as well as private capital) render necessary finished lots
• Clean title from environmental and lien standpoint, normal due diligence matters
• Third-party market study and engineer’s report be conducted
• Builder contracts are preferred, they are the “gold standard” indicators of market demand
• The bond proceeds are held by a trustee. The developer does not have access to the funds. The political subdivision (or its designee) must approve each construction requisition
• The bonds are secured by a debt service reserve fund, which serves as a “surge-tank” funding source should a tax delinquency require enforcement action
• Typically, 2-3 years’ interest is funded from the bonds
Emerging Issues From An Underwriter’s Perspective
Conduit Financings / Placements / Direct Purchases / Legislative Session / Market Volatility

• Some issuers are considering using local government corporations or authorities to keep PID related activities outside the day-to-day business of the issuer. Administering these matters outside the issuer adds to the complexity, but may make strategic sense.

• Some underwriters are attempting to negotiate agreements with Cities that MAY be monetized outside the issuer (even outside the State). If this structure is ever executed successfully, it still requires that the issuer adopt a service and assessment plan, levy / collect assessments, and engage in enforcement action for non-payment.

• Some “buy-side” firms are attempting to directly purchase bonds through placements. These issues are typically a higher-interest cost, attempt to create leverage and may create regulatory issues for Cities / Counties.

• Some investors are becoming comfortable with monetizing existing economic incentive agreements. The developer simply assigns existing cash flow to an investment vehicle at a discount. This would be “in lieu of” a future bond issue.

• The upcoming legislative session may see attempts at improving, modifying the PID statute. Some changes may include: clarifying ambiguities that currently exist, expanding permissible projects, encouraging funding of green energy, making it easier for conduit issuances.

• While in a historically low interest rate environment, there’s a sense that rates are going up. At a minimum, rates have been volatile in the last four months. PID bonds have a limited universe of buyers and the direct impact of instability can be significant.

• The Texas market has become very competitive in the last year. This competition creates pressures, good and bad, for the marketplace in general.