THE GIVE AND TAKE OF DEVELOPMENT AGREEMENTS

Olson & Olson LLP

11th Annual Local Government Seminar

January 29, 2015

Mary Ann Powell
Olson & Olson, L.L.P.
Wortham Tower, Suite 600
2727 Allen Parkway
Houston, Texas 77019
713-533-3800
mpowell@olsonllp.com
kmickelson@olsonllp.com

The Give and Take of Development Agreements

The purpose of this paper is to outline some of the ways local governments partner with the private sector. Many matters mentioned here are complex and may require detailed analysis in a given situation. The following is to assist local officials determine how best to proceed with the decision making process when dealing with a developer, business owner or landowner and when considering entering into a contractual relationship with them.

I. Development Agreements - Generally.

Development Agreement can mean any contract entered into between a governmental entity and a private one. Most often, development agreements are entered into by a local governmental entity and the landowner, developer or prospective business. Development agreements can create a mechanism for a community to ensure development occurs in a manner consistent with good planning and maximizes the benefits of a development in situations and in ways that the local entity would not otherwise be able to do, such as controlling the type and rate of growth in a city's extra territorial jurisdiction. Such an agreement can incent by rewarding certain types of development or the rate of a development, and at other times a development agreement can regulate or limit the type and way in which development occurs. Sometimes development agreements can do a combination of these.

Below are a few of the many statutory authorizations for development agreements available to local entities. Each has its own scope of authority. The listing is not exhaustive and is intended as a sampling. Sometimes a development agreement may be coupled with one or more other mechanisms to optimize the desired results of both parties, depending on the circumstances and complexity:

1. Subchapter G. Section 212.171 et seq Texas Local Government Code: Agreements under this subchapter are sometimes referred to as "Non-Annexation Agreements" or "ETJ Agreements."
2. Chapter 380 Texas Government Code: This is the statute adopted specifically to implement Texas Constitution Article III Section 52a[1] and is arguably the broadest and most flexible.

[1] *See generally* testimony of Representative McCollugh, author of House Bill 3192, before the House Committee on Urban Affiars, 71st Leg. (May 15, 1989).

3. Section 43.0751 Texas Local Government Code: These are strategic partnership agreements entered into between a city and a conservation and reclamation district operating under Chapter 49 Texas Water Code, such as with a municipal utility district.

4. 212.071 Texas Local Government Code: Also sometimes known as development participation agreements, this section is an exception from following the competitive sealed bidding procedure for the construction of certain improvements constructed by a developer depending on the percentage paid by the city and the developer, and whether the improvement relates to oversizing.

5. Chapters 311 & 312 Tax Increment/Tax Abatement agreements. These create incentives to landowners directly tied to performance and can be combined with other types of development agreements.

6. Chapters 501-507 Texas Local Government Code: Economic development corporations may enter into performance agreements in accordance with the provisions of these statutes and pursuant to a corporation's articles, bylaws and election order.

7. Chapter 552 Texas Local Government Code: Utility systems agreements to provide water, sewer, gas, or electric service outside a city's boundaries.

8. Chapter 395 Texas Local Government Code: Impact fee agreements providing for the time and method of payment of impact fees.

9. 42.046 Texas Local Government Code: Planned unit development district agreements for territory that has been disannexed by a city previously annexed for limited purposes may designate an area within its extraterritorial jurisdiction as a planned unit development district.

10. Chapters 2267 and 2268 Texas Government Code: Created by the Texas legislature in 2011, these chapters create methods for public and private partnerships to form to provide "qualified facilities" for public use.

11. Chapter 431, subchapter D, Texas Transportation Code: Through formation of a local government corporation allows various transactions and agreements to occur with more flexibility.

12. Chapter 2303.5055 Texas Government Code: Through creation of an enterprise zone agreements can be entered into relating to refund, rebate or payment of tax proceeds for hotel projects.

13. Chapter 43 Texas Local Government Code: Annexation agreements.

II. Preparation.

a. Be prepared. Being prepared before an opportunity presents itself can be of great help. Before negotiating a development agreement, cities and other local entities should assess the needs of their community. This means understanding what they have to offer a prospective private partner, and also what they have that may detract a prospective private partner from developing, expanding or locating within its borders. The more prepared a community is, the bigger the role it will have in shaping its future and in controlling how a future developer or business will impact them. A business may be knowledgeable about its industry, but a local entity will know how to make it blend with an existing community in a way that can maximize the strengths of both parties.

How do you do this? Cities can prepare by doing one or more of the following:

- Comprehensive plans. Create or update comprehensive plans or elements of comprehensive plans such as thoroughfare plans, drainage plans, park plans, trail plans, etc.
- Market and other studies. Perform market studies or needs assessments, including those provided by outside vendors.
- Workshop. Have city council or assign a committee to identify priorities and opportunities. Even without going through the cost of adopting or updating formal plans and studies, cities can identify and prioritize their strengths and weaknesses. This helps a local community know what to offer and what its needs are when talking with a prospective private partner.
- Establish policies. Adopting policies or guidelines setting forth the criteria that should be met before a city enters into a particular type of development agreement can be helpful. For example, a policy may require a minimum increased value a business must bring to a city before the city will consider entering into a tax abatement agreement.

b. Cooperation. Since the late 1980s, many cities and economic development corporations have negotiated private-public partnerships. Competition for economic development can be fierce. Cities are committed to its citizens. So, too, are its neighbors with respect to their own citizenry. Ideally, communities should work together to create a holistic, complimentary approach to economic development for a “win win” result. The more cohesive and supportive the greater community is towards economic development, the better the result. Combined studies to better understand the relative advantages of each locale can be of tremendous

value for all. This can be organized through umbrella organizations such as chambers of commerce, council of governments and similar regional organizations. For example, one community may have vast expanses of undeveloped property while another boasts a workforce that's in high demand.

c. Research. It may be recommended to research different opportunities and even hire or consult with a third party about the viability of a certain type of business or public amenity. If outsourcing, using someone who is familiar with your community, with current trends and who will respect your priorities and maintain open lines of communication is ideal. With respect to specific opportunities, incentives and desired outcomes, it may be beneficial to perform a cost benefit analysis.

d. Resources. Understanding the resources available to a local community beforehand is of great help. If city funds are involved, it will be necessary to identify which funds on hand to use and how much is available for the intended purpose. If not setting aside funds, the legal ability and feasibility of issuing debt needs to be addressed.[2] For example, home rule charters need to be reviewed, statutory authority of general law cities researched, necessity of election examined, etc. When issuing debt, certain loans of public funds may be unconstitutional without a sinking fund if secured by taxes. Avoiding double pledging of revenues or other funds vis a vis current debt obligations is important. Also, understanding the proper use of available funding sources such as hotel occupancy taxes, increased sales or ad valorem taxes attributable to development, enterprise zone funds and so on is necessary.

The Texas State Comptroller's office maintains a website found at www.texasahead.org that has useful information about various types of development agreements and their uses.

III. Negotiating the Development Agreement

a. Equal but different. There are lots of moving pieces to the puzzle when public entities partner with the private sector. Some of them are discussed below. It's important to understand that while equal, the negotiating strengths of a public-private partnership will be different from one involving

[2] *See* Op. Tex. Att'y Gen. No. DM-185 (1992).

only private parties. It may be recommended to go over the ground rules and expectations early so that later on in the negotiations a private party better understands what are some of the "non-negotiable" tenets. For example, accountability of public funds is a necessity to ensure the proper expenditure of public funds in a development agreement as discussed in more detail below. This is also when having an adopted policy to share with a prospective private partner can be helpful.

b. Terms of the Agreement. Understanding what a local community wants and has to offer, and understanding what the private entity wants and has to offer is paramount. Below are some of the most common considerations.

The City/Local entity potential wants:

-infill development
-construction of public improvements to previously undevelopable property
-creation or diversification of jobs
-higher end development from what would otherwise have been developed
-revitalizing a previously depressed area
- tax dollars into local economy
-implementation or furthering implementation of a master plan, such as a thoroughfare plan or master drainage plan
-community amenities, such as a park, convention center or entertainment district.

The Landowner/Developer/Business potential wants:

- land, such as within a business park
-consistency of local regulation of development
-reimbursement of permitting fees, or amounts representing certain collection of taxes.
-money (grant or loan)
-regulatory relief
-deferral of annexation
-infrastructure improvements

Understanding the perspective of the private partner is helpful. For example, when talking to a developer interested in infill development in an older established part of town, regulatory relief may be requested. The City cannot waive its regulatory requirements without legislative enactment. However, creation of overlay districts, planned developments and other approaches can also be discussed. In contrast,

when talking to a developer interested in building on an outlying tract of land, presence of utilities may be a source of discussions for cost sharing arrangements addressing both current developer needs as well as oversizing for future development.

c. Additional Considerations. Most development agreements are of long duration spanning typically anywhere from five, ten even 45 years. Once negotiated, the implementation phase may last for years.

It's important for a local entity to choose a private partner carefully when entering into a long term relationship. Factors to take into consideration include the following:

1. Commitment to the Community. Does the business have a commitment to the community? Has the business joined the local chamber? Will its employees be living locally? Will this include upper management? Has the business expressed interest in sponsoring local causes? Does it matter in this instance?
2. Financial and Management Stability. Has the business entity demonstrated financial strength to the satisfaction of the city? Are certain precautions in place commensurate with the level of risk the city is undertaking to ensure proper expenditure of public funds? Is the entity stable or is it undergoing a significant change in management or corporate structure? Will it impact the local project? Can the agreement adequately address the possible scenarios?
3. Communication/Chemistry. Have the negotiations gone smoothly? Have conversations been friendly? difficult? honest? heated yet productive? Have the people with whom the city been dealing been reliable? Have the people on behalf of the private entity been given adequate authority to negotiate? Does the city get along well with its private partner? Is the private partner litigious?
4. History. What is the track record of the prospective private partner? Have they developed something similar elsewhere? Was it successful? By whose standards?

Virtually all private-public partnerships have their own unique makeup including particular strengths and weaknesses. It is not realistic to expect to get everything a local entity wants in a private partner or in the agreement itself. Nonetheless, it is important to understand what the strengths and weaknesses are and to determine the importance of each.

IV. Chapter 380 Texas Local Government Code.

a. Background. Historically cities have enjoyed relationships with private entities ranging from regulator to public partner. When talking about this paper's title "The Give and Take of Development Agreements," perhaps the most common "give" can be found in Chapter 380 Texas Local Government Code. It is under this chapter that cities are able to incent developers, landowners and businesses to perform in a way that is of most benefit to a community.

While the Texas Constitution generally prohibits granting public funds or lending public credit to private parties,[3] the parameters of the relationship was altered beginning in 1987 when Section 52a of Article III was added to read as follows:

§ 52-a. Assistance to encourage state economic development

Sec. 52-a. Notwithstanding any other provision of this constitution, the legislature may provide for the creation of programs and the making of loans and grants of public money, other than money otherwise dedicated by this constitution to use for a different purpose, for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state, the stimulation of agricultural innovation, the fostering of the growth of enterprises based on agriculture, or the development or expansion of transportation or commerce in the state. Any bonds or other obligations of a county, municipality, or other political subdivision of the state that are issued for the purpose of making loans or grants in connection with a program authorized by the legislature under this section and that are payable from ad valorem taxes must be approved by a vote of the majority of the registered voters of the county, municipality, or political subdivision voting on the issue. A program created or a loan or grant made as provided by this section that is not secured by a pledge of ad valorem taxes or financed by the issuance of any bonds or other obligations payable from ad valorem taxes of the political subdivision does not constitute or create a debt for the purpose of any provision of this constitution [added in 2005]. An enabling law enacted by the legislature in anticipation of the adoption of this amendment is not void because of its anticipatory character.

[3] *See* Texas Constitution, Article III, Section 51, "The Legislature shall have no power to make any grant or authorize the making of any grant of public moneys to any individual, association of individuals, municipal or other corporations whatsoever. . . "

Considered by itself, this constitutional amendment alone did not enable cities to lend credit or make grants to private entities. Rather, it authorized the Texas legislature to enact laws to enable cities to create their own economic development programs.

In the following legislative session, Chapter 380 of the Texas Local Government Code was adopted. This was the enabling legislation needed for Texas cities to develop their own economic development programs.[4] There is no laundry list of acceptable programs and acceptable forms of incentives. Rather, the Texas constitutional prohibition from making grants of monies to private corporations remains but through the above-described amendment economic development became a recognized public purpose.

Forms of acceptable incentives referenced generally in the statute include programs that grant or loan public funds and provide city personnel and services.

b. Public Purpose. Consistent with the Texas Constitutional provisions discussed above is the requirement that the expenditure of public funds be for a public purpose. The Texas Supreme Court set forth a public purpose test as follows:

(1) is the intent to accomplish a public purpose, rather than to benefit a private party;

(2) is there public control over the funds or property to ensure the public purpose is accomplished and to protect the public's investment; and

(3) will the City receive a sufficient return for the funds or property?[5]

In order to maintain the public purpose, controls over the use of public funds or resources must be addressed in a 380 agreement. For example, accounting for how public funds are spent is a requirement. For agreements spanning several years, annual certifications or other proof of performance may be required. Proof of employment levels or caliber of jobs created may be required. Most importantly, in the event a private partner does not meet its obligations to which the grant or loan of public funds relates, there must be recapture of such public funds. These contract provisions are commonly referred to as "clawbacks." As the Texas

[4] *See generally* Texas Attorney General Op. DM-185 (1992).
[5] *Tex. Mun. League v. Tex. Workers' Comp. Comm'n,* 74 S.W.3d 377, 383-384 (Tex 2002).

Attorney General has noted, requiring "a contract or other arrangement sufficient to ensure that the funds are used for the purposes authorized, consistent with the constitutional restrictions on the expenditure of public funds"[6] is a requirement for any 380 agreement.

c. Incentives. The premise of a 380 agreement is that if the private entity performs in a certain manner, the local entity may provide incentives of public funds or resources, such as grants of money, loans, securing of loans, sale or lease of real property and so on. The program may provide for payments up front or for reimbursement upon performance.

Where use of public resources is provided in advance of performance on the part of the private partner, more and more stringent clawback provisions in the agreement may be required. If guaranteeing a loan of a developer, when and how to secure payment to avoid a scenario of developer default, city pays and city gets nothing out of the arrangement needs to be adequately addressed.

The statute does not specify the type of economic development program a city may adopt. However, there are limitations in place regarding the proper expenditure of public funds generally as discussed above from a Texas constitutional perspective, as well as other statutory limitations to consider. For example, Chapter 1502 Texas Government Code generally prohibits providing free utility services except to public schools and building and institutions operated by a city. There can be no abatement of ad valorem taxes outside of the statutory process under Chapter 312 Texas Tax Code. However, due to the flexibility of an agreement under Chapter 380, payments equal to the amount of ad valorem taxes can be negotiated.

There can be local restrictions as well regarding the ability of cities to enter into 380 agreements. Home rule cities need to check charter provisions for limitations, and general law cities may need to look at statutory authorization before adopting a 380 program or before entering into a particular agreement.

d. Flexibility. Compared to other development agreements, agreements under chapter 380 are comparatively flexible. For example, 380 agreements can be coupled with interlocal agreements to achieve a

[6] Tex. Att'y Gen. Op. No. JC-0362 (2001) at 6.

"synthetic TIRZ". Using a 380 agreement approach instead can sometimes achieve similar results with less process and less cost. Also, 380 agreements may be used in conjunction with other economic development tools and at other governmental levels such as in conjunction with the state's Enterprise Zone Program under Chapter 2303 Texas Government Code or in conjunction with an economic development sales tax 4A or 4B program. There are rules and requirements to be met with all such tools, and care should be given to consult with professionals when needed.

e. Considerations. As flexible as 380 agreements can be, there are still factors to consider when working out such an agreement. Below is a sampling, some of which has been mentioned earlier:

i. Necessity to maintain public use and purpose of public funds.
ii. Necessity of establishing a program for the making of loans or grants or use of public services.
iii. Necessity of accountability of public resources.
iv. Necessity of clawback provisions.
v. Prohibition against using public funds to pay undocumented workers and necessity of stating this contractually pursuant to Chapter 2264 Texas Government Code.
vi. Understanding funding sources, including from current funds versus debt.
vii. Understanding authority and limitations placed on authority to enter into agreement, whether for home rule cities or general law cities.
viii. Reimbursement versus immediate availability of public funds.
ix. Grant or loan.
x. Roughly proportional legal concepts vis a vis the 380 agreement.
xi. Public procurement requirements vis a vis the 380 agreement.
xii. Whether to use a 380 agreement in conjunction with other local development and economic development tools to achieve certain results.
xiii. Whether and if a city is able to partner with other public authorities.

V. Implementation of Project.

a. Generally. Once a development agreement has been approved by all the parties, the implementation phase starts. Understandably, there is a great sense of achievement upon final negotiation of a development agreement.

Implementation is the next phase. As mentioned earlier, private-public partnerships often last for many years, making the selection, negotiating and ongoing relationship important. How all phases of this relationship play out should be taken into consideration. Depending on the length of the agreement and the priorities of the respective parties, the specificity with which various topics are discussed will vary.

b. Enforcement. To ensure success, communities may want to consider designating staff or hiring outside services to manage a development agreement or project involving a development agreement. Depending on the complexity, it may be worthwhile to have both a contract manager and a construction manager to ensure adequate oversight and to address issues before problems arise.

There can be times, however, when you may have to deal with a 380 agreement that is not progressing to the satisfaction of one or both parties. For example, a company was to have completed public infrastructure by a certain timeframe or in a certain manner but failed to properly perform. What to do?

As a political subdivision tied to its geographical location, it may be in the best interests of the public partner to first attempt to mutually resolve such problems. For example, a delay because of unforeseen supply shortages may be fleeting. However, the pulling out of an equity partner associated with the landowner or developer may be quite serious. A failing project is not going to move and what happens in a community stays there.

Although neither party likes to think about problems with performance, a public entity should prepare for this possibility by having in place as many protections as is reasonable. Sometimes an escrow fund may be appropriate. Depending on the amount of risk, it may be necessary to have extensive provisions for recapture of public funds. What safeguards are available depends on the situation. When constructing public infrastructure there may be limitations on what can be required in certain situations. [7] Also, the private partner could respond by asserting a takings claim, estoppel or waiver of governmental immunity.

[7] *See* e.g. Tex. Letter Opinion 90-180 interpreting 212.901 Texas Local Government Code requiring surety to guarantee development does not also authorize requiring performance or payment bonds.

It is important to maintain good communications, conduct periodic checks and to perform periodic cost benefit analysis or outside audits to measure and keep abreast of a public-private agreement.

VI. Conclusion. There are many types of development agreements. It is outside the scope of this paper to discuss all facets of such agreements. Rather, it is designed to make the reader aware of some of the considerations, attributes and limitations of development agreements generally and specifically with respect to those under Chapter 380 of the Texas Local Government Code.

With adequate preparation, meaningful negotiations and a thoughtfully prepared agreement tailored for the situation at hand, the likelihood of a successful outcome is maximized. Great partnerships can bring great things to both the city and the private partner.