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Via Electronic Mail

(opinion.committee@oag.texas.gov)

The Honorable Ken Paxton
Attorney General of the State of Texas
Attention: Opinion Committee
P.O. Box 12548
Austin, Texas 78711-2548

Re: Questions Relating to the Use of Public Improvement District Assessments to Pay Certain Costs and the Necessity of Attorney General Review of Promissory Notes issued by a Local Government Corporation

Dear Attorney General Paxton:

I have been requested to submit this request for an attorney general opinion on behalf of the City of Hutto, Texas (the "City") with regard to the below questions. The City has informed me that it intends to perform all of its lawful obligations under the relevant transaction documents discussed herein and, therefore, seeks clarification from the Attorney General's Office in order that it may do so. All information below was provided to me by the City and its legal counsel. Although I do not have personal knowledge of the factual background information submitted, I am relying on the representations provided by Williamson County, the City, and its legal counsel regarding the factual background and known legal authorities and, based on those representations, I believe these questions are appropriate for submission to your office for an opinion.

Questions:

1. May public improvement district assessments be levied by a city under Chapter 372 of the Texas Local Government Code and used by the city to make installment payments through an interlocal agreement for the purchase of public improvements from the city's local government corporation, if the installment payments are sized to enable the corporation to pay debt service on a loan from an out-of-state bond issuer which was used to fund the cost of constructing the improvements, and to pay financing costs of issuing the bonds by the out-of-state issuer?
2. Does Chapter 431 of the Texas Transportation Code require that a loan agreement and promissory note executed by a local government corporation formed under such Chapter

be submitted to the Attorney General for examination if the promissory note is not a “public security”?

Factual Background:

On June 7, 2018, the City Council of the City of Hutto, Texas passed and approved a resolution authorizing the creation of the Hutto Co-Op Public Improvement District (the "District") pursuant to Chapter 372, Texas Local Government Code, as amended (the "PID Act"). The District was created, in part, to undertake and finance certain public improvements as defined in the District's Service and Assessment Plan and Assessment Roll (the “SAP”), which was approved by the City Council pursuant to an ordinance adopted on December 6, 2018 (the “Assessment Ordinance”). In addition, the City authorized the formation of the River Creek Development Corporation (the “Corporation”) as a local government corporation pursuant to Subchapter D of Chapter 431 of the Texas Transportation Code, as amended (“Chapter 431”) in order to assist and act on behalf of the City to accomplish any governmental purpose of the City, including the financing of various development projects within the District.

Pursuant to a written loan agreement (the “Loan Agreement”) and associated promissory note (the “Note”), the Corporation borrowed money from the Public Finance Authority, a unit of government and a body corporate and politic of the State of Wisconsin (the “Wisconsin PFA”), for the purpose of constructing certain public improvements in the District and to fund certain reserve funds and pay capitalized interest on and costs of issuing bonds by the Wisconsin PFA. The Wisconsin PFA issued \$17,400,000 of “Public Finance Authority Public Improvement Revenue Bonds (Hutto Co-Op Public Improvement District Project), Series 2018” (the “PFA Bonds”) in order to raise the funds it lent to the Corporation.¹ The Corporation entered into a construction contract with a third party (the “Construction Manager”) for the development and construction of the improvements and paid (or is paying) for such improvements with the money borrowed from the Wisconsin PFA under the Loan Agreement. The City authorized the Corporation to enter into the construction contract and the Loan Agreement pursuant to Section 4.01 of the Interlocal Agreement (defined below).

The SAP identified the initial authorized improvements to be constructed within the District, set an initial budgeted cost for such improvements at \$17,400,000, and established the amount of assessments (the “Assessments”) on the benefitted property within the District based on such budgeted amount. Pursuant to the Assessment Ordinance, the City Council levied the Assessments against certain parcels within the boundaries of the District in accordance with the SAP and determined that the Assessments were to be paid in annual installments over a thirty-five (35) year period, as shown in the SAP, with interest. The PID Act provides that an Assessment can be paid in full at any time, but if not paid in full, the City may collect interest and collection costs on the outstanding Assessments.

The City and the Corporation entered into an Interlocal Agreement (the “Interlocal Agreement”) pursuant to which the City agreed to purchase the improvements from the Corporation in consideration for scheduled installment purchase price payments. The purchase price to be paid by

¹ The PFA Bonds were issued as two term bonds: \$13,985,000 6.250% Term Bonds, Due October 1, 2050, Priced to Yield 6.250%; and \$3,415,000 6.300% Term Bonds, Due October 1, 2053, Priced to Yield 6.300%.

the City is the sum of all payments specified on a schedule which mirrors the debt service schedule of the Note. The Interlocal Agreement states that such payments are special obligations of the City payable solely from District assessment revenues. The City pledged to the Corporation, and granted a lien on and a security interest in, all of the District assessment revenues. In turn, the Corporation pledged to the Wisconsin PFA revenues it receives under the Interlocal Agreement as security for the Loan, and the Wisconsin PFA pledged revenues it receives from the Corporation to secure payment of the PFA Bonds. The Interlocal Agreement expressly states that proceeds from the PFA Bonds were to be used to (i) finance the loan to pay the Construction Manager's actual cost of the public improvements to be constructed in the District, (ii) fund capitalized interest, (iii) fund an extraordinary expense fund, debt service reserve fund, and other funds under the trust agreement securing the PFA Bonds, and (iv) pay certain costs of issuing the PFA Bonds. City staff, City attorneys and other City consultants were involved in all aspects of negotiating and documenting the above-described financing. In reliance on the advice of outside legal counsel, City Council approved all documents to which the City is a party, and the governing board of the Corporation [which is comprised of three members appointed by the City Council] approved all documents to which the Corporation is a party. The Corporation is required to comply with all financial and administrative ordinances and policies of the City.

Discussion and Analysis:

1. Public Improvement District Assessments

Texas law has long held that special assessments may only be levied on property in an amount based on the benefits such property receives from the improvements to the property. *See City of Houston v. Blackbird*, 394 S.W. 2d 159, 162 (Tex. 1965) (“An assessment against property and its owner for paving improvements on any basis other than for benefits conferred and in an amount materially greater than the benefits conferred violates Sec. 17 of Article 1 of the Constitution of Texas . . .”). The PID Act incorporates this concept, stating, “[t]he governing body of [a] municipality or county shall apportion the cost of an improvement to be assessed against property in an improvement district. The apportionment shall be made on the basis of special benefits accruing to the property because of the improvement.”²

The PID Act authorizes a city to levy assessments to pay costs of public improvements and to provide that assessments be paid “in periodic installments, at an interest rate and for a period approved by the governing body.”³ The PID Act also specifies what may be included in the “cost” of improvements for which special assessments may be levied. Costs of improvements payable from assessments that are payable in installments may be paid “under an installment sales contract or a reimbursement agreement . . . or by the issuance and sale of bonds under Section 372.024”⁴ of the PID Act. Section 372.003 of the PID Act does list certain “soft” costs and services among “authorized improvements” permitted to be financed under the PID Act, including “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” as well as “payment of

² Section 372.015(a) of the PID Act.

³ Section 372.017(b) of the PID Act.

⁴ Section 372.023(d) of the PID Act.

expenses incurred in the establishment, administration, and operation of the district.” However, it does not expressly authorize financing costs among “authorized improvements.” That is addressed by Section 372.023(h).

Section 372.023(h) of the PID Act provides that the costs of an improvement include “*all costs incurred in connection with the issuance of bonds under [the PID Act] and [such costs] may be included in the assessments against the property in the improvement district....*”⁵ Section 372.024 of the PID Act allows revenue bonds to be issued to pay permitted costs under the PID Act and to be “secured by liens on all or part of the revenue derived from improvements authorized under [the PID Act], including revenue derived from installment payments of special assessments.” Except as provided in Section 372.023(h) of the PID Act, costs of issuing bonds is not included among the list of expressly “authorized improvements” under the PID Act.⁶

The PID Act authorizes the City to pledge installment payments of assessments to secure the payment of bonds, temporary notes, time warrants, installment sale contracts or reimbursement agreements authorized by Subchapter A, Chapter 372, Texas Local Government Code to finance improvements.⁷ The PID Act also provides that the City may enter into an agreement with the Corporation that provides for payment to the Corporation of amounts pledged under Section 372.026 to secure indebtedness issued by the Corporation to finance improvements, “including indebtedness to pay capitalized interest and a reserve fund permitted by [Subchapter A] for revenue or general obligation bonds issued under [Subchapter A] and indebtedness issued to pay the corporation's costs of issuance.”⁸

Based on the above statutory framework, there seems to be authority for the City to levy assessments to pay for the costs of improvements which benefit the District. However, the City does not appear to be expressly authorized to levy assessments on property within the District to pay for costs of issuing bonds not issued by the City or a local government corporation formed by the City in accordance with the PID Act. Since Section 372.003 of the PID Act does not include costs of issuing bonds in its list of “authorized improvements” and the bonds were issued by the Wisconsin PFA and, therefore, were not issued under the PID Act (or approved by the Texas Attorney General), the PID Act does not appear to authorize assessments to be used to pay the cost of issuing the PFA Bonds or fund reserve funds of the Wisconsin PFA.

With those statutory restrictions noted, the installment sale nature of the Interlocal Agreement may have been intended to address the lack of clear statutory authority for District assessments to be levied to support the payment of the financing costs of the Wisconsin PFA. Section 372.023(d)(1) of the PID Act authorizes the City to pay costs payable from assessments under the terms of an installment sales contract between the City and a person who acquires, installs, or constructs public improvements. In this instance, the City would be acquiring the improvement from the Corporation (which is acquiring the public improvements from the Construction Manager, which is

⁵ Section 372.023(h) of the PID Act (emphasis added).

⁶ See Section 372.003(b) of the PID Act.

⁷ Section 372.026(b) of the PID Act.

⁸ Section 372.026(f) of the PID Act. Perhaps somewhat ironically, if the Corporation had issued the bonds directly (as opposed to entering into a Loan Agreement), there is express statutory authority for a contract between the City and the Corporation to allow for the transfer and pledge of the assessments.

constructing them pursuant to its construction contract with the Corporation). The argument is that, while the purchase price which the City is paying to the Corporation may include the cost of the Corporation's financing of the District improvements, that is just a component of the purchase price of the improvements under an installment sales contract, so is part of the "cost" of the improvements. However, we are aware that in certain other instances where public entities have tried to employ creative agreements to address statutory restrictions associated with debt issuances, the Attorney General has opined that there is a public policy argument "*to look beyond the face of the transaction and to hold unlawful any agreement having the effect of avoiding the statutory prohibitions.*"⁹ The question seems to turn on whether an "installment sales contract" between the City and an entity controlled by the City provides sufficient legal authority for all stated installment payments due under such a contract to be authorized "costs" of improvements and, therefore, payable from annual installments of assessments, or does the law require that we look beyond the contractual characterization of the payments to the actual use of the funds as financing components associated with the underlying bonds, which were not issued under the PID Act and, therefore, are not permitted to be paid with assessments under the PID Act.

2. Examination of Promissory Note by Attorney General

Chapter 431 of the Texas Transportation Code generally authorizes the creation of corporations, which are limited to the promotion and development of public transportation facilities and systems; however, Subchapter D of such Chapter further authorizes the creation of local government corporations to aid and act on behalf of one or more local governments to accomplish any governmental purpose of those local governments. Section 431.071 of the Texas Transportation Code (which applies to both "corporations" and "local government corporations"¹⁰) states, in part, that "[a] corporation shall submit a bond or note authorized under Section 431.070 [of the Texas Transportation Code] and a contract supporting its issuance to the attorney general for examination."¹¹ Section 431.070 contains broad authority for "[a] corporation [to] issue bonds and

⁹ In Texas Attorney General Opinion CM-0634, the Attorney General was asked whether the Texas Water Development Board (the "TWDB") had the legal authority to make a commitment to political subdivisions to purchase bonds in the future. Tex. Att'y Gen. Op. CM-0634 (1970). Normally, the TWDB would sell its bonds to obtain funds to purchase bonds from political subdivisions to fund projects. However, due to market factors, the TWDB could not sell its bonds within the interest rate limitation prescribed in the Texas Constitution. As a result, the TWDB sought to make commitments to purchase bonds issued by political subdivisions from third-party holders or purchase refunding bonds from the political subdivisions in the future. The Attorney General opined that the TWDB could not make such commitments, as doing so "would constitute an effort to avoid the constitutional limitation upon interest rates," noting that "*it is the policy of the law to look beyond the face of the transaction and to hold unlawful any agreement having the effect of avoiding the statutory prohibitions.*" *Id.* at 6 (emphasis added); *see also Christie v. Harris County Fresh Water Supply Dist. No. 23*, 317 S.W.2d 219 (Tex. Civ. App. – Waco 1958, writ ref'd n.r.e.) (quoting Am. Jur., "As in the case of other restrictions designed to limit the contracting of indebtedness by municipal corporations and other political bodies, numerous schemes have been devised to get around the statutory provision against a sale of public bonds for less than par. Finding themselves unable to sell bonds at par, officers in charge of bond issues frequently seek to accomplish indirectly what they are prohibited from doing directly. Needless to say, the courts have been prompt to declare invalid all such indirectness. As in other cases where it is sought to do indirectly what cannot be done directly, it is the policy of the law to look beyond the face of the transaction and to hold unlawful any agreement having the effect of avoiding the statutory prohibition.").

¹⁰ Section 431.003(2), Texas Transportation Code, states, "corporation" means a corporation organized under this chapter and includes a local government corporation."

¹¹ Tex. Transp. Code § 431.071.

notes to carry out its purpose.”¹² In addition, Section 431.006 provides that the Texas Non-Profit Corporation Act¹³ applies to a corporation formed under Chapter 431 “to the extent that the provisions of that Act are not inconsistent with this chapter.”¹⁴

A plain reading of the word “note,” as used in Section 431.071, would seem to include “promissory note,” but it is not clear whether other relevant statutory language or context limits that reading. The use of the word “issue” does not seem to limit the broad meaning of the word “note” because there are many other statutory uses where “issue” clearly indicates an issuance of a promissory note.¹⁵ Under a *noscitur a sociis*¹⁶ theory of statutory construction, there may be an argument that the use of the word “bond” before the word “note” informs the meaning of “note” to be limited to the type of note that is similar to a bond, but since only two words are included in the statutory list, the authoritative weight of such a statutory construction theory is diminished. Alternatively, a corporation formed under Chapter 431 (including a local government corporation) could arguably rely on the general authority provided by Chapter 22 of the Business Organizations Code (f/k/a the Texas Non-Profit Corporation Act) to issue promissory notes and enter into loan agreements for permitted corporate purposes. Generally, without an additional statutory requirement, an issuance of a promissory note by a local government entity would not require a review by the Attorney General unless such note is a “public security.”¹⁷ However, does the wording of Section 431.006 limit the applicability of the general authority of Chapter 22 of the Business Organizations Code because of the express statutory requirement contained in Section 431.071 that “notes” be submitted to the Attorney General or the express statutory statement in Section 431.108 that the operations of a local government corporation are governmental? Does this statutory analysis result in a requirement that all promissory notes issued by a Chapter 431 corporation or a local government corporation (regardless of whether such notes are public securities) be submitted to the Attorney General for examination?

¹² Tex. Transp. Code § 431.070 (emphasis added).

¹³ The former Texas Non-Profit Corporation Act (Article 1396-1.01 et seq., Vernon's Texas Civil Statutes) is now codified as Chapter 22 of the Texas Business Organizations Code.

¹⁴ Tex. Transp. Code § 431.006.

¹⁵ See Tex. Local Gov't Code § 382.152(b) (“A district may not *issue a negotiable promissory note* or notes unless approved by the commissioners court...”) (emphasis added); Tex. Transp. Code § 366.072(e) (“...described by Subsection (c), an authority may borrow money and *issue promissory notes* or other interest-bearing evidences of indebtedness payable out of...”) (emphasis added); Tex. Transp. Code § 366.174(c)(4), (5) (“...of a turnpike project or system; (5) borrow money and *issue promissory notes* or other indebtedness payable out of the revolving fund for...”) (emphasis added), among others.

¹⁶ *Noscitur a Sociis* (aka the Associated-Word Canon) basically stands for the proposition that words that are associated with each other in a statute (such as in a list) should affect one another's meanings; however, that rule of statutory interpretation is not codified in the Texas Code Construction Act (Chapter 311 of the Texas Gov't Code).

¹⁷ Section 1203.003, Texas Government Code, requires a “public security” to be submitted to the Attorney General for approval before “issuance.” Section 1202.001, Texas Government Code, defines “public security” to include a note, but only if it is payable to bearer or the registered owner, and the Section defines “issuance” as the delivery of a public security to the initial purchaser in exchange for the purchase price.

If you have any questions concerning this request, please feel free to contact me or Dorothy Palumbo, City Attorney of the City of Hutto. Thank you for your attention to this opinion request.

Respectfully submitted,



Dee Hobbs
Williamson County Attorney

cc: **Via Electronic Mail**
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