HOUSE RESEARCH ORGANIZATION

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Hearing Reviews Limits on City Annexation and Development Powers

City powers to expand and to regulate development within municipal boundaries were scrutinized at a House Land and Resource Management Committee hearing December 3. Topics included annexation processes used by cities to encompass surrounding territory, municipal authority to impose ordinances on existing development projects, and the state's ability to overrule city zoning decisions when state land is involved. While these issues affect cities throughout Texas, invited testimony focused on recent developments in Austin as a case study.

Annexation process faulted

The committee heard testimony regarding Austin's plans to annex 22 square miles of territory with nearly 35,000 residents. Witnesses described contentious hearings characterized by angry confrontations between the city, arguing for the need to broaden its tax base to all who use city services, and residents of municipal utility districts (MUDs), counterclaiming that they should not be annexed without their agreement.

Austin Mayor Kirk Watson conceded that the city had been guilty of annexation abuses in the past and stressed that the current plan was designed to remedy some inequities. For example, Austin plans to annex areas adjoining territory along US 183 that had previously been strip annexed. Although the city will not see a positive cash flow from all the neighborhoods in these areas, Watson said, fairness dictates that they be included within the city limits. He added that the city's annexation plan was based on three factors: economic health, social equity, and regional and environmental planning.

Annexation is vital in cities such as Austin that have experienced an explosion of suburban growth, Watson said. Unless the city is able to annex outlying territory, he said, its tax base will erode and services will suffer to the point that the wealthier landowners move to the suburbs, creating a downward spiral of decay in the inner city. Watson added that MUDs typically are created with the clear intention of some day being annexed. Developers, he said, often must sign annexation consent agreements when creating a MUD and are required by state law to provide notice of such agreements to buyers purchasing property within the district.

While conceding that annexation may be necessary to stabilize a municipal tax base, several witnesses representing MUDs maintained that the annexation process must account for the rights of residents. MUDs may have developed orginally as a means of financing developments but have since evolved into a new form of government that is more immediately responsive to its citizens. MUD residents feel more closely connected to their MUD board than to a large city proposing to engulf them, witnesses said. The point is not so much whether the city can reduce taxes or provide better services, but whether residents are willing to relinquish local control to a less responsive city government, they said.

Despite their disagreements on the equity of annexation, witnesses united on one point: that the annexation

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process itself is responsible for much of the animosity that surrounds annexation proposals.

Watson explained that state law requires that annexation occur within 90 days after a first resolution on the motion is passed by a city council. This requirement makes it appear that the process is being rushed, he said. Watson advocated a longer annexation period, up to six months, in order to allow the two sides an opportunity to confer and work out any disagreements.

Watson added, however, that a longer process would have to include provisions preventing MUDs from precluding annexation with such "poison pills" as long-term service contracts, which financially obligate a district, or zero tax rates, which keep cities from generating any revenue from an area for one full year until they can apply their own municipal tax rates.

Rep. Mike Krusee, a member of the committee and a resident of one of the MUDs scheduled to be annexed by Austin, likened the annexation process to a mugging. In the rushed negotiations that precede annexation, MUDs are willing to do anything to put off being annexed, he said. For example, he said, Austin-area MUDs facing annexation have proposed a variety of "desperation" options. One MUD proposed postponing annexation for five years, during which time it would annually increase the tax rate. It also promised to refrain from any efforts aimed at preventing annexation, including any criticism of the annexation agreement. Other MUDs proposed postponing annexation while they used their tax revenues to finish building fire stations and parks. The MUDs can't be faulted for resorting to such proposals, Krusee contended, any more than a mugging victim can be blamed for handing over his wallet.

Both city and MUD representatives also testified that any new annexation process should build on the Strategic Partnership Agreement (SPA) concept enacted by SB 1396 by Barrientos in 1995. The bill established a two-year moratorium on annexation by cities with limited purpose annexation powers, requiring such cities to develop agreements with areas in order to annex them. However, both sides also pointed to flaws with the bill. City representatives said the two-year moratorium was too harsh and allowed MUDs to circumvent the bargaining process. It also gave MUDs ample opportunity to create poison pills aimed at spoiling future annexation. MUDs said the moratorium worked both ways: cities likewise had little incentive to come to the bargaining table since they could simply wait to annex an area without an agreement.

Committee Chair Fred Bosse predicted that the 76th Legislature will see well over 100 bills on annexation, exceeding the number filed during the last session.

New debate on development ordinance

The House Land and Resource Management Committee also heard opposing testimony on a new Austin ordinance setting deadlines for development projects. The ordinance was drafted after SB 1704 by Shapiro was unintentionally repealed during the 1997 session. SB 1704 was enacted in 1995 following several years of negotiations on using planning laws as a way of regulating the ability of cities to enforce new ordinances on already approved development plans. It required that city ordinances in effect when a development project began apply for the duration of the project. A developer could not be required to comply with new ordinances passed after a project was approved but before it was completed.

While SB 1704 applied to all municipalities, it was seen as a curb on Austin, primarily because of the city's history of changing building standards and retroactively applying ordinances. According to Ken Jones, an attorney with Armbrust & Brown, Austin has passed 79 such regulations in the past five years; most Texas cities pass an annual average of five development ordinances. Critics of SB 1704, on the other hand, point out that it lacked time limits for completion of projects. In cities that did not set their own time limits on development, such as Austin, SB 1704 allowed projects to develop according to city ordinances in effect when they were first approved, even if a substantial period of time had passed and no substantive work had been performed since the original plan was filed.

SB 1704 was inadvertently repealed by SB 932 by Sibley, which abolished the Texas Department of Commerce and transferred its duties to the Texas Department of Economic Development.

In the wake of the repeal, Austin created a committee of developers and environmental representatives to draft a replacement ordinance. Depending on their nature and location, new projects now must begin within one or two years following plan approval or be subject to new ordinances. According to city representatives, this time frame represents a satisfactory compromise that allows

Annexation Hot Spot

Circle C Ranch in southwest Travis County is a particular hot spot in the controversy over Austin annexation plans. The 74th Legislature in 1995 attempted to resolve a long contentious relationship between Circle C developers and the city of Austin with HB 3193 by Saunders, which removed the MUD from Austin's extraterritorial jurisdiction and created the Southwest Travis County Water District. Enactment of HB 3193 meant that Austin could not annex the area nor impose city regulations there, including a controversial ordinance strictly regulating impervious ground cover in the Barton Creek watershed. Gov. George W. Bush allowed the bill to become law without his signature.

On August 26, 1997, State District Court Judge Scott McCown upheld Austin's challenge to HB 3193, ruling that the law violated constitutional provisions prohibiting local and special laws. Judge McCown directed that Austin and Circle C attempt mediation to resolve the dispute. The attempt failed, and Judge McCown's order became final. Austin subsequently initiated annexation procedures, which Judge McCown refused to stay pending appeal on the ground that there was little likelihood of the ruling being overturned. Higher courts had recently ruled against laws enacted in 1995 as unconstitutionally targeting Austin (*Austin v. Cedar Park,* 953 S.W.2d 424 (1997), involving SB 421 by Wentworth, Third Court of Appeals; *Maple Run v. Monaghan*, 931 S.W. 2d 941 (1996), involving SB 1261 by Barrientos, Texas Supreme Court). Circle C's numerous requests for temporary restraining orders and appeals of Judge McCown's decision were denied. On December 18, the Austin City Council approved the annexation of Circle C Ranch.

Committee members asked what would happen if the McCown ruling were overturned after Austin annexed the area. Witnesses representing Circle C testified that it would be virtually impossible to disannex the area and reconstitute the four MUDs encompassing the majority of Circle C and the Southwest Travis County Water District. They said similar circumstances were involved in unsuccessful attempts during the 75th Legislature to disannex the Kingwood subdivision from Houston. Some witnesses said that Austin may have been prompted by the Kingwood episode to annex Circle C before being prevented by additional court or legislative action.

Questions were raised as well about the financial impact of the Circle C annexation. Representatives from Circle C asserted that the figures available to them showed annexation would result in a loss of revenue to the city. They also complained that the city had refused to release all of the figures it had used to calculate its financial plans for the annexation. Representatives from Austin countered that the financial projections did show a positive cash flow from Circle C once a proposed water and sewer rate increase was allocated to that area. According to these witnesses, the assumptions behind the city's numbers are protected under the Public Information Act because they also had been used to calculate projections for bids still pending. Witnesses added that the numbers also are protected under the litigation exemption of the Public Information Act due to the suit Circle C filed against the city.

Nevertheless, Mayor Watson and Assistant City Manager Toby Futrell testified, revenue generation was not the sole consideration in annexing the property. If it were, annexation probably would not occur until the project was completely built out in another 10 years. By annexing the area while it is still only partially developed, they said, Austin could control growth in the area, contributing to regional and environmental planning. Representatives from the city also stated that there were no ulterior motives in annexing the area in advance of an appeals court ruling or the next legislative session. The annexation simply occurred at the first available opportunity after HB 3193 was declared unconstitutional.

developers time to complete projects yet prevents them from sitting on property for so long that building under old ordinances creates risks to public safety and the environment. Previously, Austin lacked any deadline for a development to stay current; the new time limits move Austin in line with most other Texas cities, they said.

Jones, however, said the new ordinance is a confusing law that creates multiple time lines for different types of developments. It also is designed to discourage development in certain parts of the city without regard to the environmental needs of those areas, he said. Furthermore, the ordinance fails to require the city to review and approve plans in a timely manner, Jones added. The plan approval process often takes in excess of one year, precisely the start-up deadline for some projects under the new ordinance.

Susan Horton, general counsel of the Texas Municipal League, said Austin, because it was most affected by SB 1704, is the only major city that has passed new rules to fill the gap left by the bill's repeal. Horton noted that many other cities are reviewing their development processes to determine if they might be affected by the repeal. Chairman Bosse directed that a representative sample of cities be surveyed on this question with an eye to evaluating if new legislation is needed.

Controversy over Hog Farm sale

The state's ability to overriding municipal zoning authority also came under scrutiny, as the House Land and Resource Management Committee was briefed on details of a disagreement between Austin and the state concerning development plans for a parcel of land that the General Land Office (GLO) has contracted to sell.

The 446-acre tract, still known as the Hog Farm based on its former use, is located within Austin city limits in a fast growing section of Williamson County. Madron Investments has offered to buy the parcel from the Texas Department of Transportation for $18.3 million, nearly $6 million higher than the next highest bid, so long as the GLO can secure the zoning changes needed to develop the property to what the agency calls its fullest potential: a high density commercial and multi-family residential project. The state applied for such changes on behalf of Madron Investments to the city of Austin. The city rejected the proposed development on November 20, 1997.

Although the contract is not contingent upon the zoning waiver, the buyer has indicated plans to break the contract if the zoning plan is not approved. Madron Investments would then forfeit $250,000 in earnest money. The state, however, stands to lose at least $6 million, the difference between the high bid from Madron Investments and the next highest bid.

If the land did not belong to the state, the city's rejection would be the end of the proposal. However, the Natural Resources Code allows the state to convene a six-member special board to review the city's decision with the option of overruling it to allow the proposed development. The board of review for the Hog Farm project includes Texas Land Commissioner Garry Mauro and the other two members of the School Land Board, Texas Transportation Commissioner David Laney, Austin Mayor Kirk Watson, and Williamson County Judge John Doerfler. Because four of the six members represent the state, critics have charged that the process is weighted against the city. Austin officials also have expressed concerns that the board of review process strips a city of its authority to effectively regulate development within its own borders.

Complicating the issue is SB 1396 by Barrientos, 1995 legislation affecting Austin's authority to regulate zoning in parts of the city outside Travis County. The legislation prohibits Austin from considering the impact of traffic congestion in the area when ruling on a development proposal. The committee was told Austin city council members discussed traffic issues and the impact of SB 1396 when they examined the proposed Hog Farm development. Council members stated they were uncomfortable with the idea that they could not examine traffic issues in ruling on a zoning case, but the city did not specifically deny the plan based on those issues. The special board of review convened by the state is not limited by SB 1396, and has ordered that a traffic impact study be conducted.

A December 17 meeting planned for the board of review was postponed until mid-January.

— by John J. Goodson

Mixed Reviews on Financial Status of Public Employee Benefit Plans

The Teacher Retirement System (TRS) is fully funded after last year's banner year on the stock market, witnesses told the December 2 hearing of the House Pensions and Investments Committee. Last fiscal year, TRS saw a 25 percent return on its investments, increasing the current market value of the fund by $12 billion to more than $65 billion. However, officials from the Employees Retirement System (ERS) cautioned that the state Uniform Group Insurance Program faces a potential $278 million funding shortfall in fiscal 2001 if current funding and spending trends continue.

TRS enjoys bullish investments

The TRS is actuarially sound and is virtually "fully funded," according to Charles Dunlap, executive director of the system. In a fully funded pension system, current assets and future anticipated contributions are sufficient to cover accruing liabilities and pay benefits to all active and retired members and their beneficiaries. The strong financial position of TRS is largely a factor of the recent bull stock market, which has produced investment gains far in excess of the 8 percent annual actuarial assumption. However, because of the volatility of the stock market, Committee Chair Barry Telford cautioned, TRS should not "push the envelope" on its unfunded liabilities.

Rep. Paul Sadler asked whether a fully funded system could mean increased benefits for Texas teachers. Dunlap explained that the system could easily afford to fund the fourth and final installment in a series of increases given by the Legislature to raise retirement benefits to allow retirees' annuities to keep up with inflation, but that TRS may not be in a position to increase the retirement formula multiplier from 2 to 2.25, as ERS did last session.

TRS officials also updated the committee on the Deferred Retirement Option Plan or "DROP" program instituted September 1 following enactment of SB 2644 by Telford. In general, DROP programs permit workers who are eligible for retirement to stay on the job for up to five years. During this time, their retirement annuity accumulates in an account. The annuity is given to them, usually in a lump sum, when they actually retire and leave work. Pay increases and continued service for the years worked under the deferred plan are not credited toward retirement, an aspect that some observers criticize as reducing the amount of annuity received. Others, however, say DROP plans benefit retirees by allowing them a cash nest-egg as well as an annuity.

This retirement benefit is popular among firefighter and police pension plans as a way of keeping experienced personnel from retiring. About 26 uniform retirement systems in Texas have instituted DROP plans; TRS is the first state retirement system to provide this option to members. The TRS DROP program is designed to be actuarially neutral, which means it pays for itself and does not put additional cost on the pension system.

TRS active members who have 25 years of service and are eligible to receive a standard annuity may participate in the DROP plan. At the beginning of December, 734 of 2,109 eligible TRS members requesting to participate had enrolled in the program. The retirement account of each is credited with 79 percent of the annuity the member would have received if retiring at the time the DROP account was opened. Deposits are continued for a minimum of one and a maximum of five years. When the member actually retires, the account balance, plus 5 percent annual interest, is distributed to the member, either in one lump sum payment or in timed payments.

Although TRS members are generally pleased with the DROP program, TRS benefits director Norma Koontz said, some have complained that the plan is complicated and difficult to understand. Others have said the plan should be transferable to the ERS system. Still others have called for increasing the proportion of annuity that is deposited as well as the interest rate earned on the account. Both those amounts now help to ensure that the plan is revenue neutral.

Group insurance shortfall projected

ERS Executive Director Sheila Beckett warned the committee about rising costs to the state Uniform Group

Insurance Program, which provides health and disability insurance for all state employees and retirees, including higher education employees outside the University of Texas and Texas A&M University systems. Beckett said the program could require additional state funding of $278 million in 2001.

Beckett attributed the funding shortfall in part to increasing costs from a higher than expected number of doctor visits and growing prescription drug usage, and to past draws on the reserve fund balances to help pay for other state programs. The self-funded program is required to maintain minimum fund balances of 10 percent of projected expenditures. State funding and employee premiums are increasing 2 percent a year for fiscal 1998 and 1999, but ERS projections show that the minimum fund balance will be in the hole by $233 million at the beginning of 2001 and that the program will need further funding increases of 12 percent a year in 2000 and 2001.

The insurance program is reviewing a range of cost containment options that could begin in fiscal year 1999. These include:

- competitively bidding HMOs and reducing the number of HMOs in certain areas;
- separately bidding administration of HealthSelect, HealthSelect Plus, and the prescription drug program, all of which are currently administered by Blue Cross/Blue Shield of Texas;
- increasing HealthSelect co-pays for physician visits and prescription drugs and coinsurance for medical services;
- modifying the HealthSelect pharmacy network; and
- educating and encouraging members to use generic rather than name brand drugs.

Beckett said that ERS does not anticipate reducing overall program costs by undertaking any massive restructuring or decrease in benefits now available to members.

A special subcommittee, chaired by Rep. Dale Tillery, was named to study the ERS uniform group insurance program.

— by Patricia Tierney Alofsin

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