

Legal Q&A

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Q What is a municipal utility district?

A A municipal utility district (MUD) is a state governmental entity that provides utility services to certain defined areas. TEX. WATER CODE § 54. These utility services may include water, sewage, drainage, parks, and roads. *Id.* MUDs are most commonly created to serve as water districts.

Q How are municipal utility districts relevant to cities?

A When a municipal utility district is created, the landowner often funds necessary infrastructure for the development. The city may benefit from the developer's fronting of costs that allow for utilities. MUDs then issue bonds to pay back the developer for its initial infrastructure costs.

The MUD effectively works as a financing vehicle for the facilities once taxable value emerges to support issuance of bonds. Developers then recover their infrastructure investments; meanwhile, the MUD also raises revenue through ad valorem taxes on property within the district for the purpose of bond repayment, maintenance etc.

Q What are the purposes of municipal utility districts?

A The Texas Water Code expressly defines the purposes of municipal utility districts as follows:

1. The control, storage, preservation, and distribution of its stormwater and floodwater, the water of its rivers and streams for irrigation, power, and all other useful purposes;
2. The reclamation and irrigation of its arid, semiarid, and other land needing irrigation;
3. The reclamation and drainage of its overflowed land and other land needing drainage;
4. The conservation and development of its forests, water, and hydroelectric power;
5. The navigation of its inland and coastal water;
6. The control, abatement, and change of any shortage or harmful excess of water;
7. The protection, preservation, and restoration of the purity and sanitary condition of water within the State of Texas; and
8. The preservation of all natural resources of the state. TEX. CONST. art. XVI, § 59; TEX. WATER CODE § 54.012.

Q What are the powers of MUDs?

A The Texas Water Code also defines the powers of municipal utility districts.

These districts are authorized to purchase, construct, acquire own, operate, maintain, repair, improve, or extend inside and outside its boundaries any and all works, improvements, facilities, plants, equipment, and appliances necessary to accomplish the purposes of the district authorized by the constitution, the Water Code, or other law, including all works, improvements, facilities, plants, equipment, and appliances incident, helpful, or necessary to achieve the following:

1. Supply water for municipal uses, domestic uses, power, and commercial purposes and all other beneficial uses of controls;
2. Collect, transport, process, dispose of, and control all domestic, industrial, or communal wastes whether in fluid, solid, or composite state;
3. Gather, conduct, divert, and control local storm water or other local harmful excesses of water in a district;
4. Irrigate the land in a district;
5. Alter land elevation in a district where it is needed;
6. Navigate coastal and inland waters of the district; and
7. Provide parks and recreational facilities for the use of inhabitants in the district, subject to the provisions of Chapter 49. TEX. WATER CODE § 54.201(b).

Q What other actions may a MUD take?

A A MUD has the power to exercise eminent domain within the district, oversee roads with TCEQ approval, authorize contracts, manage street lighting, enforce real property restrictions, and issue bonds. *Id.* §§ 54.234-37; 54.501.

Q Does a landowner in the ETJ have the unilateral authority to create a MUD?

A No. A landowner pursuing a MUD in a city's extra-territorial jurisdiction—where the overwhelming majority of MUDs that directly affect cities are located—must first seek the city's consent to the creation of the MUD. *Id.* § 54.016. This step begins a long process of MUD creation defined in the Texas Water, Local Government, and Administrative Codes,

Q How specifically is a MUD created?

A Various statutes define the process of MUD creation. TML acknowledges Emily W. Rogers for her organization of this process in her presentation at the 2022 Texas City Attorneys Association Summer Conference.

1. The landowners seek consent from the city in which the proposed MUD would occupy that city's extra-territorial jurisdiction. The landowner also consults with the county government and allows its comment on the creation of the MUD. TEX. LOC. GOV'T CODE § 42.042; TEX. WATER CODE § 54.0161.
2. If the city wishes to consent to the creation of the district, it must do so within 90 days after the city receives the written request. If the city does not consent in the 90-day

period, the owners of at least 50 percent of the land may send a petition to the city to provide water service, sewer service, or both.

3. The landowners must provide notice of the petition before its submission to the city by posting it for 10 days in three public places within the area of the proposed MUD and by publishing it in a newspaper of general circulation in the area. TEX. LOC. GOV'T CODE § 42.043(c).
4. The landowners must present the petition to the city secretary or city clerk.
5. The city has 120 days to make a contract with the landowners to provide water and sewer services within statutorily prescribed time periods. Such a contract must provide that construction of the facilities begin within two years and will be substantially completed within 4.5 years of the petition. If no agreement is reached, the law considers the city to have consented.
6. Owners of 50 percent of the land then file a petition for the creation of the MUD to the Texas Commission on Environmental Quality.
7. The TCEQ reviews the petition and sends notice of the petition and information on how to request a hearing to "interested persons" and the county court. The landowner must publish notice in a regularly published or circulated newspaper in the county once a week for two consecutive weeks. TEX. WATER CODE § 54.018; 30 TEX. ADMIN. CODE § 293.12.
8. The TCEQ Commissioners will review any hearing requests to determine if they came from "affected parties." TEX. WATER CODE § 54.020.
9. If the Commissioners determine one or more of the requestors is affected, the TCEQ refers the matter to the State Office of Administrative Hearing for a contested case hearing.
10. After the hearing, the administrative law judge writes a proposal for decision. This proposal for decision is a recommendation to the TCEQ Commissioners whether to grant or deny the petition to create the MUD.
11. If the Commissioners grant the petition, the MUD will be created.

Q What can a city consider when deciding whether to consent to the creation of a MUD?

A The Water Code defines the factors both available and unavailable to cities. Section 54.016 begins with the general rule of city consent: "No land within the corporate limits of a city or within the extraterritorial jurisdiction of a city, shall be included in a district unless the city grants its written consent, by resolution or ordinance, to the inclusion of the land within the district in accordance with Section 42.042, Local Government Code, and this section." TEX. WATER CODE § 54.016(a).

A city cannot place restrictions on noncity service districts, which are districts that will not connect with a city's water system or contract with a regional water or wastewater provider to which the city has made a capital contribution. *Id.*

Nor can a city “require annexation as a consent to creation of any district.” *Id.* Additionally, a district’s noncompliance with valid consent requirements applicable to the district is the only circumstance in which a city may refuse to approve a bond issue. *Id.*

Municipalities retain some power at the negotiating table, however. A city may require that the district’s facilities serve the land according to city-approved plans and specifications, which includes a right to inspection. *Id.* § 54.016(e). A city may also include restrictions on terms of district bonds and conditions on the sale of district bonds that do not generally render the bonds and notes of districts in the city’s extraterritorial jurisdiction unmarketable. *Id.*

Q What factors will the TCEQ consider when determining whether to grant the petition for a MUD?

A The TCEQ determines whether the project is feasible, practicable, necessary, and beneficial to the land. The Texas Water Code defines the factors used for this determination:

1. The availability of comparable service from other systems, including but not limited to water districts, municipalities, and regional authorities;
2. The reasonableness of projected construction costs, tax rates, and water and sewer rates; and
3. Whether or not the district and its system and subsequent development within the district will have an unreasonable effect on the following:
 - (A) Land elevation;
 - (B) Subsidence;
 - (C) Groundwater level within the region;
 - (D) Recharge capability of a groundwater source;
 - (E) Natural run-off rates and drainage;
 - (F) Water quality; and
 - (G) Total tax assessments on all land located within a district. TEX. WATER CODE § 54.021(b).

Q Is an election required to create a MUD?

A There is no election required for MUD creation; however, an election is required to approve the MUD’s ability to issue bonds. In one election, voters in the district confirm or elect directors to the MUD board and determine whether to authorize the board to issue bonds. The ballot options will simply read, “For District” and “Against District.” TEX. WATER CODE § 49.102(c). Although the election covers authorization of future bond issuances, the district may only issue bonds after the developer has added value to the land and after the TCEQ has approved them. The election occurs after the city consents or the TCEQ approves the MUD.

Q Is there a limit on projected MUD tax rates?

A The Texas Administrative Code limits the combined projected tax rate into three categories separated by county.

- \$1.50 in Harris, Galveston, Montgomery, Fort Bend, Waller, and Brazoria Counties;
- \$1.20 in Dallas, Denton, Collin, Tarrant, Travis, Hays, Williamson, Comal, and Guadalupe Counties; or
- \$1.00 in all other counties. 30 TEX. ADMIN. CODE § 239.59(k)(3).

Q How is a MUD governed?

A The TCEQ first appoints a five-member board to govern the MUD. TEX. WATER CODE § 54.101. Residents of the district later vote in elections for the five positions, which have four-year terms and are unsalaried. *Id.* § 49.103.

MUDs may also hire consultants and advisors to assist in the day-to-day operation of the district.

Q Is a MUD subject to the Open Meetings Act and Open Records Act?

A Yes. MUDs must comply with these transparency laws by, for instance, providing proper notice of meetings and responding to requests for records.

Q Can a city annex a MUD?

A Yes, under certain circumstances. Although consent to the creation of a MUD cannot be conditioned on annexation, potentially there can come a time when a MUD wishes to be annexed by a city or vice versa. A city may not annex a MUD into its limits until both parties enter into a “strategic partnership agreement.” TEX. LOC. GOV’T CODE § 43.0751(c). Such an agreement can provide for annexation of the MUD into the city. In an annexation, the city would have to assume any outstanding MUD bonds and extinguish that debt by paying the bond investors. Prior to entering a strategic partnership agreement, the city and the MUD’s governing bodies must provide proper notice to the public and conduct at least two joint public hearings. *Id.* § 43.0751(d). Note that upon full purpose annexation, the MUD’s ad valorem tax goes away, and the property within the former MUD would be subject to the city’s ad valorem tax rate.

Q What provisions may be included in a Strategic Partnership Agreement?

A Because the city assumes the debt from the MUD, the city may stipulate in a strategic partnership agreement that the district “shall not incur additional debt, liabilities, or obligations, to construct additional utility facilities, or sell or otherwise transfer property” without the city’s prior approval. *Id.* § 43.0751(i). The two forms of annexation under a strategic partnership agreement are limited-purpose annexation and full-purpose annexation.

In a limited-purpose annexation, the MUD continues to exist within the city’s boundaries. *Id.* § 43.0751(f)(1). Strategic partnership agreements for these annexations must include the district’s boundaries, functions, name, and, if the annexation will later become full-purpose, the procedure for ending the district. *Id.* § 43.0751(g). A municipality may also impose sales and use taxes within the district’s boundaries. *Id.* § 43.0751(k).

A full-purpose annexation essentially dissolves the MUD by placing the district fully within the city boundaries and eliminating the need for a MUD governing board. *Id.* § 43.0751(h).

Furthermore, an agreement cannot require the district to pay the city for the agreement. Such agreements must also be reasonable and equitable in their benefits to both parties. *Id.* § 43.0751(p).