Governing A Growing Region:
Addressing Challenges of Service Provision and Development in Houston
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The governance of the Houston region is split among hundreds of government jurisdictions, including cities, counties and hundreds of special districts, particularly municipal utility districts. This fragmented regional governance system is responsible for directing the provision of essential services to residents across jurisdictions and therefore influences the region's growth and development practices.

This system has facilitated the Houston region’s rapid growth and will continue to play a central role in its future. For many, it functions effectively. Most MUDs are on firm financial footing and effectively help communities function. But, zooming out from individual communities and taking a regional view, major issues with the regional governance system appear on the horizon. Reforms to address key issues should be considered to ensure long-term regional stability, the fiscal health of all jurisdictions and government’s ability to support services for residents in every community.

In short, government entities in the Greater Houston region are struggling to provide urban-level services to all residents, especially those in unincorporated, non-central suburban areas. The current system of providing services is uneven.

Residents in municipalities receive the full range of services in exchange for a higher property tax rate. But many cities, especially the City of Houston, face long-term financial problems around liabilities and infrastructure challenges that hamper their service provision abilities. Residents in MUDs receive some services in exchange for a higher property tax rate, but MUDs were never designed to be permanent entities and do not provide all services. Residents in unincorporated areas outside MUDs receive few municipal-level services. Like all urban counties in Texas, Harris County is expected to provide municipal services even though it does not have the taxing and ordinance powers necessary to provide those services.

Greater Houston’s dispersed urban growth pattern amplifies these issues by creating growing service demands in hard-to-serve areas. While this growth has been central to the region’s economy, it also represents a major challenge to the region’s long-term health.

Maintaining the current approach to suburban development and regional governance without reform will mean the region will continue to suffer from overstretched service provision and exhausted city and county budgets. Both the City of Houston and Harris County face a mounting challenge maintaining solvency and a consistent level of service as more and more residents, and their tax revenue, move to unincorporated areas. Reforming the current arrangements in ways that help the city and county continue to thrive, while not shifting an unfair burden onto suburban residents and those who live in special districts such as MUDs, is crucial to the long-term health of the region.

The purpose of this report is to highlight how cities, counties and MUDs relate to one another and provide services, to identify issues associated with the current governance system and to provide possible alternatives where appropriate. While the focus of this report centers on the City of Houston, its extraterritorial jurisdiction and Harris County, the takeaways apply to many neighboring jurisdictions.
Methodology

Researchers conducted 14 interviews with experts on regional governance from cities, counties and MUDs and other special districts. We also analyzed over 30 years of data about special districts and their finances. This information was collected by Municipal Information Services, Inc. The analysis herein was conducted by consultants with TischlerBise and the Kinder Institute.

Throughout this report, unless otherwise noted, the numbers and statistics that describe MUDs are for the tax year 2015, the last year of available data in the full district database used for this analysis. The districts described here are those within the City of Houston's extraterritorial jurisdiction, which includes districts in Harris, Fort Bend and Montgomery counties. The MUD statistics cited here do not include all water districts, though the numbers for remaining water districts are summarized throughout the report and in a supporting document on the Kinder Institute website. The focus on MUDs, in particular, is because of their prevalence in the Greater Houston region.

Findings

- Expansive extraterritorial jurisdiction control for cities like Houston complicates the process of annexation. The City of Houston is not annexing and its control of the ETJ prevents MUDs from joining smaller cities or incorporating. The breakdown in the City of Houston's annexation process has led to special districts increasingly filling a general purpose-like role within the ETJ.

- New annexation limitations are likely to make future annexations more difficult outside of those done through strategic partnership agreements and careful planning between special districts and cities.

- Municipal taxpayers pay county taxes equal to those in unincorporated areas and receive regional services such as health care, flood control and law enforcement in return. However, counties rarely invest equal amounts of funding for infrastructure and service provision back into cities. This leaves cities responsible to raise required funds for maintenance and operations within their boundaries.

- Cities and MUDs are currently collecting significant sales tax benefits through limited purpose annexation but cities are generally not providing services in those MUDs.

- Urban, fast-growing counties do not have adequate revenue sources or statutory powers to provide the urban level of services residents in dense unincorporated areas desire. This is becoming a major issue, as urban counties face mounting costs in order to provide core functions and services for residents living outside of cities.

- Lower-income, unincorporated areas that are not part of a city or special district face obstacles to improving infrastructure without access to additional revenue. The burden to serve these communities falls on the counties.

- Some older MUDs with sewage treatment and water plants at the end of their functional lives will likely require massive investments in the future. MUDs with low tax rates may need to raise taxes or extend debt payments, use reserve funds, seek public assistance through available county or state funding programs or collaborate with public entities on improvement projects to ensure these systems continue to function.

- MUDs allow residents to support their own service needs with property taxes that are often lower than neighboring cities, but—unlike taxes generated inside Houston and other diverse cities—their financial resources are not used across a wide range of communities to support services everywhere.

- Including special districts, there are more than 500 government jurisdictions operating within Houston's extraterritorial jurisdiction (which encompasses 1,171 square miles in five counties).

- Harris County has the most MUDs in the state of Texas. Three counties—Harris, Fort Bend and Montgomery—collectively hold 70 percent of the districts in Texas and 78 percent of their collective taxable value.

- MUDs hold 23 percent of all tax assessed property values within Harris County, more than the rest of unincorporated Harris County.

- MUDs carry more outstanding general obligation debt than either the City of Houston or Harris County (each of which have additional long-term legacy debts for pensions and healthcare). MUDs have strong bond ratings and no legacy liabilities.
### Options Overview

<table>
<thead>
<tr>
<th>Number</th>
<th>Option</th>
<th>Description</th>
<th>Affected Entities</th>
<th>Page Number</th>
<th>Pros</th>
<th>Cons</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td><strong>Structural Reforms</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1-1</td>
<td>Regional Reforms</td>
<td>Give all governments skin in the game in regional issues. Either consolidate governments or introduce regional revenue sharing.</td>
<td>All</td>
<td>31</td>
<td>Addresses equity, regional health, improves regional economy</td>
<td>Politically and logistically difficult, revenue loss in affluent communities</td>
</tr>
<tr>
<td>1-2</td>
<td>County-Level Reforms</td>
<td>Address county-level revenue shortfalls via an Urban County designation, provide sales tax or ordinance-making power to counties, reform LPAs, or establish road districts to pay for growing road costs.</td>
<td>County and City</td>
<td>33</td>
<td>Covers county revenue shortfalls, more county oversight for development</td>
<td>Perception of large government, requires shift in state policy</td>
</tr>
<tr>
<td>1-3</td>
<td>City-Level Reforms</td>
<td>Reform current city practices: reform the ETJ for large cities, reform municipal planning commissions, leverage SPAs for targeted annexation of stressed or annexable MUDs, or create new cities and townships.</td>
<td>County and City</td>
<td>35</td>
<td>Reduces burden on county, reduces number of governments</td>
<td>Doesn’t solve regional governance issues, politically difficult, requires residents to be self-motivated</td>
</tr>
<tr>
<td>1-4</td>
<td>General Reforms</td>
<td>Introduce some general reforms such as HOA reserve funds and introduce additional board training and education opportunities for MUD boards.</td>
<td>County and City</td>
<td>37</td>
<td>Delineates responsibility, reduces inconsistencies</td>
<td>Doesn’t solve regional governance issues, doesn’t resolve funding issues</td>
</tr>
<tr>
<td>2</td>
<td><strong>Increased Collaborations</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2-1</td>
<td>City, County and MUD</td>
<td>Build on existing collaborations to facilitate regional governance. Expand on City-County, County-MUD and City-MUD collaborations or introduce a regional infrastructure evaluation.</td>
<td>County and MUDs</td>
<td>38</td>
<td>Delineates responsibility, builds on existing partnerships</td>
<td>Doesn’t introduce revenue, doesn’t solve regional issues</td>
</tr>
<tr>
<td>2-2</td>
<td>MUD to MUD Collaborations</td>
<td>Build on and introduce more MUD to MUD collaborations to facilitate regional governance. Encourage wider usage of the master MUD model or more MUD to MUD annexations.</td>
<td>County and MUDs</td>
<td>40</td>
<td>More coordination among MUDs, keeps perception of small government</td>
<td>Requires initiative and consent from residents, doesn’t fix regional issues</td>
</tr>
</tbody>
</table>
Although Houston is one of the largest and fastest-growing metropolitan areas in the nation, the system that governs development and provides essential services outside of incorporated cities in the region faces challenges. Though metropolitan regions across Texas confront this issue, it is particularly acute in the Greater Houston region.

Since the early 1960s, the City of Houston has controlled new development in its vast extraterritorial jurisdiction (ETJ), which extends into parts of five counties up to 5 miles beyond city limits and covers 1,171 square miles (See Figure 3). Since the late 1990s, however, the city has rarely moved to fully annex developing areas. At the same time, Houston’s control of its ETJ has meant that unincorporated areas with a strong tax base cannot be annexed into other cities or incorporate on their own without Houston’s permission. Without annexation and incorporation as options, service provision in unincorporated areas has been assumed by hundreds of MUDs, which collect taxes, issue bonds and provide some unincorporated areas with many—but not all—services.

Harris and surrounding counties provide services such as road maintenance and law enforcement to their respective unincorporated territories. In Texas, however, most counties in quickly growing metropolitan areas confront a limited capacity to raise revenue, thus making it difficult to both pay for core regional services such as law enforcement and health systems and also keep up with the service demands of residents in unincorporated areas.

The MUDs help fill this gap by providing some services to residents inside their boundaries. They were not intended to function as general purpose governments, but with the breakdown of annexation, and the ongoing need to provide services to new developments, they increasingly function in a similar manner.

Many of those involved in the MUD industry argue that the system works well and MUD residents are well served. Houston-area MUDs are generally solvent, many have large fund reserves for contingencies and provide reliable service. Most MUDs have declining tax rates and high bond ratings.

Yet despite the advantages offered by the existing regional governance and service provision structure, there are numerous underlying issues that, if not addressed effectively, could prevent the system from best serving everyone involved.

### FIGURE 2

**Housing and Population by Local Jurisdiction**

<table>
<thead>
<tr>
<th>Entity</th>
<th>Square Miles</th>
<th>Housing Units</th>
<th>Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harris County</td>
<td>1,777</td>
<td>1,660,235</td>
<td>4,538,028</td>
</tr>
<tr>
<td>Harris County (not including MUDs or cities)</td>
<td>664</td>
<td>29,322</td>
<td>380,481</td>
</tr>
<tr>
<td>City of Houston</td>
<td>627</td>
<td>927,107</td>
<td>2,239,558</td>
</tr>
<tr>
<td>ETJ MUDs</td>
<td>403</td>
<td>552,545</td>
<td>1,520,084</td>
</tr>
<tr>
<td>Smaller Cities</td>
<td>209</td>
<td>294,078</td>
<td>798,053</td>
</tr>
</tbody>
</table>
INTRODUCTION

City of Houston ETJ as of 2018

Houston Region Boundaries
- Blue: Houston Incorporated Boundary
- Pink: Extraterritorial Jurisdiction Boundary

Source Data: City of Houston
Created By: Matthew Krause
The City of Houston’s ongoing control over development within its expansive ETJ—along with its lack of annexation—limits the options that growing areas of the region have as they mature. Houston controls land in its ETJ that it will not likely ever annex, yet remains the primary decision maker around the planning and development standards in those areas. In addition, Houston and other cities have embraced tools such as limited purpose annexations that provide revenue for the MUDs and the cities but not other service providers such as counties.

At the same time, the City of Houston’s budgets are stretched thin and the city faces major issues with its sewer and water treatment systems. City residents pay county taxes as well as city taxes. While they receive regional services, city residents do not benefit much from the county’s investment in infrastructure. For example, of the $2.5 billion Harris County has slated for road and bridge maintenance and construction over the next five years, only about $100 million is currently slated to be spent inside the city. In contrast, MUD taxpayers also pay county taxes but the county—not the MUDs—pay for most road and storm sewer maintenance over the long-term.

Some MUDs, especially older ones with lower tax rates, may face challenges related to unsupported long-term maintenance, such as aging sewer or water plants that will require significant funding to upgrade or replace. This funding can be secured through the use of reserve funds, which many MUDs have, through the sale of new bonds and tax increases, through collaboration and cost-sharing with public entities or through the use of public funds. In some cases, Harris County has used portions of its Housing and Urban Development community development block grant funds to help pay for this type of project. In 2005, for example, Harris County MUD 50, which serves Barrett Station and adjacent areas in eastern Harris County, received nearly $725,000 dollars in CDBG money to pay for a sewer system upgrade and extension. MUDs can also secure loans from the Texas Water Development Board through its Clean Water State Revolving Fund.

Even where MUDs exist, the responsibility for providing many services falls on Harris and surrounding counties, which have limited revenue-raising capability. The problem is particularly acute for Harris County, which is an urban county of 1,700 square miles, of which more than 1,000 square miles (59 percent) is unincorporated. More than 2 million of Harris County’s 4.5 million residents live in unincorporated areas. This situation is unusual among large urban counties in Texas. Dallas County, for example, has 68 square miles of unincorporated territory, only 7.5 percent of the county’s square area.

There is also the question of whether this system has effectively created “second-tier” communities with fewer resources and outdated infrastructure. This is particularly acute in unincorporated areas that have no MUD or other
special districts to raise funds. In these instances, the lack of tools and funds to improve communities leaves them at a relative disadvantage. It also means that many infrastructure improvements will fall to Harris County and surrounding counties to engineer, finance and maintain through their limited financing mechanisms or federal programs such as the CDBG program.

In short, government entities in the Greater Houston region are struggling to provide adequate, urban-level services to all residents, especially those in unincorporated, non-central suburban areas. The current system of providing services is uneven.

- Residents inside municipalities receive the full range of services in exchange for a higher property tax rate, though the City of Houston in particular faces difficult long-term financial problems that limit its ability to provide adequate services.
- Residents inside MUDs receive some services in exchange for a higher property tax rate, but MUDs were never designed to be permanent entities and do not provide all services.
- Residents in unincorporated areas outside MUDs receive few municipal services. Like all urban counties in Texas, Harris County is expected to provide municipal services even though it does not have the taxing and ordinance powers necessary to provide those services.

Greater Houston’s dispersed urban growth pattern amplifies these issues by creating growing service demands in hard-to-serve areas. While this growth has been central to the region’s economy, it also represents a major challenge to the region’s long-term health.

Both the City of Houston and Harris County face a mounting challenge maintaining solvency and a consistent level of service as more and more residents, and their taxes, move to areas outside of these core jurisdictions. Reforming the current arrangements in ways that help the city and county continue to thrive, while not putting an unfair burden on suburban residents, is crucial to the long-term health of the region.

The response to Hurricane Harvey offers an example of the type of regional cooperation that already exists and shows the importance of building upon such foundations. After the storm, MUDs and Harris County collaborated closely on documenting Harvey damage and response. The options considered in this report represent a range of approaches intended to help create a system where all residents, whether in a city, a special district or in an unincorporated part of the county, are able to easily and evenly access essential services being provided by government jurisdictions that are working closely with one another to create a thriving metropolitan area.
Much of the challenge of regional governance boils down to which entity is providing which services to which residents and how they are paying the cost of those services. Government services are typically handled by general purpose governments such as cities and counties. These governments possess specific taxing and regulatory powers to build and manage such systems. However, across the country, state and local governments have turned to special district governments as a way to provide a single service through an entity with limited taxing and regulatory powers.

**Services**

The constellation of local governments must provide two different types of services.

First are **regional** services such as road maintenance, flood control, public health, jails and courts. In Texas, these services are typically provided by counties and, in some cases, by large cities such as Houston.

Second are **municipal** services, such as water and sewage, drainage, streets, solid waste, law enforcement patrol services, development review and quality-of-life services such as libraries and parks.

Texas law envisions a system in which regional services are provided mostly by counties and municipal services are provided mostly by cities. For this reason, counties have no ordinance-making power (e.g., they cannot regulate noise or public health issues); no power to provide water and sewer services; and limited powers for development review. Cities—especially large cities—have the power of development review in their ETJ. MUDs were designed as a financing mechanism used to build infrastructure in areas municipalities could not immediately serve and were intended to function as service providers only until annexation.

**Houston Region Service Provision Roles**

<table>
<thead>
<tr>
<th>Service</th>
<th>County</th>
<th>City</th>
<th>MUDs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water/Sewage</td>
<td>–</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Local Drainage</td>
<td>Maintenance Only</td>
<td>X</td>
<td>Limited</td>
</tr>
<tr>
<td>Streets</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Solid Waste</td>
<td>–</td>
<td>X</td>
<td>Contract</td>
</tr>
<tr>
<td>Law Enforcement</td>
<td>X</td>
<td>X</td>
<td>Contract</td>
</tr>
</tbody>
</table>
The City of Houston, however, has done very little annexation for the past 40 years, even as it has retained development review power—and the power to approve MUD creation—in its expansive ETJ. This has led to the permanent and broader use of MUDs to fill some, but not all, of the service gaps.

MUDs provide permanent water and sewer services and in most cases, contract for solid waste and law enforcement patrol services—usually contracting with either the Sheriff’s Office or Constables for the latter. Newer MUDs also often provide parks and other quality-of-life services.

Roads, however, remain primarily a county responsibility. In unincorporated areas, including those areas with MUDs, Harris and other counties are responsible for maintaining roads and pertinent storm sewers after they are built. Harris County maintains 6,800 miles of roads primarily in unincorporated parts of the county, 57 percent of that total (3,895 miles) are within utility districts, most of which are MUDs. In 2018, the county budgeted $417,401,833 for roads and bridges and the bulk of that money was spent in its unincorporated areas. Inside a MUD, the initial developers pay for the construction of most streets and storm sewers and are reimbursed for portions of those costs. After construction, the county is responsible for maintenance and any subsequent expansion based on need. The expansion or updating of road or storm sewer capacity is often undertaken as a collaboration between MUDs and the county on a cost-sharing basis. These collaborations give counties important input into the shape and standards of infrastructure within MUDs.

By contrast, within their corporate limits, cities have full responsibility for roads and drainage. They can also provide solid waste and law enforcement. With a few exceptions, the City of Houston generally does not provide services to the MUDs within its ETJ. Some MUDs and other districts contract with the city for access to water supply, and in some limited purpose annexations (LPAs), the city provides some services, but those are not consistent across all such agreements.

MUDs are capable of providing all water- and sewage-related services. As mentioned above, MUDs can construct most local streets and drainage networks, but in most cases, they then give those systems to the counties to maintain. Although they hold no regulatory power of their own, MUDs have benefited from state laws that expand their responsibilities to include the power to contract for services such as law enforcement or solid waste. In addition to the contracting capabilities, the Texas Legislature has given certain MUDs the ability to build and maintain roadways. Likewise, since 2003, some MUDs have been given the power to sell revenue bonds specifically for parks and trails. MUDs may also add territory via annexation into the district with the permission of the city that controls the surrounding ETJ.

Although they are technically private entities, homeowners associations (HOAs) are closely tied to the operations of most MUDs and are used in many other communities across the region. In general, HOAs maintain common amenities and enforce covenants, conditions and restrictions in place within a community as a part of deed restrictions. In MUDs with an HOA, MUDs tend to be responsible for the major infrastructure of a community and HOAs are usually responsible for maintaining public amenities such as surface drainage systems, parks or pools. In some cases, HOAs are responsible for maintaining private roads as well.

**Revenue**

Counties, cities and MUDs pay for these services in different ways. The limitations on their available revenue streams typically dictate their ability to provide services.

In Texas, property and sales taxes are the primary mechanisms for paying for public services.

Property rates are typically set by each taxing entity, such as cities, counties, school districts and special districts such as MUDs. Thus, the overall property tax rate is typically higher inside cities and MUDs than in unincorporated areas without MUDs. There is no overall cap on property tax rates but such caps are the subject of considerable discussion at the state level. For example, Gov. Greg Abbott has called for a cap on property tax at 2.5 percent growth.

Sales tax rates are currently capped at 8.25 percent. Inside most cities, this cap is met between the state tax (6.25 percent), a city tax (1 percent) and a transportation authority or another special sales tax (1 percent). In unincorporated areas, some counties (those without transportation authorities), transportation authorities, other special taxing entities such as emergency service districts (which provide fire and EMS coverage) and limited purpose annexations tend to increase the rate to reach the cap. As it stands in Harris County, even though the county is prohibited from collecting sales tax, there are few areas where there is room to collect additional sales tax. Similar to property taxes, a discussion of capping or limiting the expansion of sales taxes is likely to be a subject of close attention in the state legislature.
**County revenue**

In Texas, counties rely heavily on property taxes for their general fund revenue. Harris County’s adopted property tax rate was $0.42 per $100 of value in 2017, which produced $1.86 billion, or 51 percent of the county’s total revenue.

Counties also control the budgets of countywide taxing jurisdictions such as flood control districts. In Harris County, the Commissioners Court oversees the budgets of three entities with additional property tax powers—the Harris County Hospital District ($0.17 per $100 value for 2017), the Harris County Flood Control District ($0.028 per $100 value for 2017) and the Harris County Department of Education ($0.005 per $100 value for 2017).

Counties in Texas can assess a sales tax only if they do not also have a transportation authority within their boundaries. One mechanism available to counties with transit authorities, such as Harris County, is to assess a sales tax in a limited area through a County Assistance District. This tool allows counties, with voter approval, to create districts within which they can collect between 0.125 and 2 percent of additional sales tax, to be used only for infrastructure or services within the district.14 This tool can only be put into place where the 8.25 percent sales tax cap has not been met. Several such districts have been created in Fort Bend County.15

Because of limited revenue capability, counties—especially populous counties such as Harris County—are stretched to pay for road and storm sewer maintenance demands, which are their responsibility in all unincorporated areas, including inside MUDs.

**City revenue**

Cities in Texas mainly rely on property taxes (City of Houston’s adopted tax rate for 2017 was $0.58 per $100) and sales taxes for their general revenue (the City of Houston takes 1 percent of the 8.25 percent sales tax collected inside the city limits). In FY 2017, the City of Houston collected $1.13 billion, or 45.42 percent of the total budget, in property tax and $615 million, or 24.65 percent of the total budget, in sales tax. The City of Houston’s property tax rate is subject to a revenue cap, which limits the revenue increases to a combination of inflation and population growth and has caused the ad valorem tax rate to drop by $0.05 per $100 over the past four years.

The City of Houston and other cities have used strategic partnership agreements and limited purpose annexations to enter into agreements with MUDs and other utility districts. These agreements allow cities to collect sales tax within a district and to split that revenue with the district. LPAs typically come with no guarantee of services from the city. In 2017, the City of Houston collected $106 million in sales tax from 227 LPAs and split that revenue with those districts. Houston views the LPAs as a way to collect revenue from area residents that benefit from accessing city services and amenities while in the city, but do not contribute significantly to city revenues outside of sales tax. City of Houston officials estimate that approximately 700,000 people from outlying areas come into the city each day for jobs and amenities, thus using the city’s infrastructure.16

The City of Houston is cash-strapped and struggles to provide services across its large corporate limits. This is clearly seen in recent struggles to adequately update its sewer systems and prevent sewage overflows.17 It is also one reason why it no longer annexes territory. This means that the City of Houston is unlikely to be a key factor in helping address service issues or costs in unincorporated areas not served by special districts.

**MUD revenue**

Most MUDs are financed through property taxes ($0.68 per $100 value average tax rate in 2015). MUDs not only have bonding authority, but can also collect operation taxes and water and sewer revenue fees, which can be collected in addition to the taxes levied for paying debt service. MUDs are created either through approval by the Texas Commission on Environmental Quality (TCEQ) or through legislative actions. Their specific powers vary depending upon the powers laid out in their creation documents.

While MUDs provide a range of services to their districts very well, they are—similar to cities—unable to help address issues outside their boundaries. In addition, older MUDs that are facing potential issues with either outdated or undersized infrastructure may confront challenges in paying for required improvements without selling additional bonds and raising tax rates or collaborating with other public entities to pay for needed improvements.

**Homeowners Association Revenue**

HOAs can collect assessments and fees from residents to support both regular maintenance and any unexpected needs.18 In most cases, HOAs are not required to have contingency funds and must raise additional funds through special assessments.19
The Growth of MUDs and Shifting Annexation Practices

In the aggregate, the Houston area’s MUDs contain a population and development value equivalent to a very large city. The 370 or so MUDs in the Houston ETJ cover 400 square miles, include 550,000 housing units and hold 1.5 million people—a “city” almost exactly the same size as San Antonio. Together they hold a bonded indebtedness approaching $6 billion, approximately the same as the general obligation debt held by the City of Houston and Harris County combined (not counting long-term liabilities such as pension costs). Viewed on a map (See Figure 5), the MUDs cover much of the northwestern part of Greater Houston. Indeed, if all MUDs in Houston’s ETJ were annexed, the city would almost double in size to more than 1,000 square miles of area and 4 million people (approximately the same population as Los Angeles, the second most populous city in the United States).

Within Harris County alone, MUDs are central to the growth of the Houston region and their evolution will help shape the region’s future. Though 58 percent of Harris County’s 1.6 million housing units are inside Houston city limits, 24 percent are located inside MUDs and additional 18 percent are inside of smaller cities within Harris County. Unincorporated Harris County, outside of MUDs and small cities, has only 2 percent of the county’s housing units (Figure 6).

This is a unique situation in Texas. As Figure 7 shows, 70 percent of all MUDs and 78 percent of their taxable value in Texas is located in the Houston region. These districts are less common in other populous regions because either the core city has continued to annex (San Antonio and Austin) or most residents live inside incorporated cities (Dallas and Fort Worth). Texas’ other major cities either have fewer special districts overall or have embraced different types of special districts, such as public improvement districts (PIDs) which are more directly under those cities’ control and have a less stringent regulatory structure to enable growth.

MUDs were not intended to exist permanently. Historically, they have served as development startup tools, providing developers with a way to finance and construct utilities in areas where municipalities could not or would not do so. In most cases, MUDs were annexed into a city such as Houston after bonds were paid off or near final maturity or the city limits and city’s services reached the development. As the annexation system has stalled in Houston, though, MUDs have necessarily assumed roles usually played by more permanent governments.

The Texas Legislature has formally recognized this reality several times by expanding the powers MUDs can possess. Over time, by offering expanded road building powers and enabling MUDs to add quality-of-life amenities such as parks and trails, the legislature has effectively transformed MUDs into general purpose-like governments. These additions have been spurred both by increased consumer demand for such amenities and by the reality that MUDs are functioning as permanent, primary governments in many places.
FIGURE 5
MUDs in the City of Houston ETJ

Source Data: City of Houston
Created By: Matthew Krause
This greater permanence is also reflected in the fact that newer MUDs are spending more of the funds they collect on operations and maintenance relative to what they are spending on debt service (Figure 8). There are two likely reasons for this shift. First, newer MUDs often have higher operations and maintenance taxes in order to build up a reserve of funds to pay for major contingencies. Second, newer MUDs that have built up quality-of-life amenities and recognize their more permanent function are maintaining higher operations and maintenance costs.

The Houston ETJ contains most of the MUDs in Texas for several reasons.25

First, the City of Houston had no major municipal competition for growth in the metropolitan area for most of the 20th century, freeing the city to grow outward and to use MUDs to aid that growth.

Second, the Houston region’s spread-out form of development has relied heavily on MUDs because of their ability to finance public infrastructure systems in areas disconnected from existing municipal services.

Third, the region is flat and the water table is accessible. The topography has allowed for the easy expansion of development. The accessible water table makes the provision of water service logistically easy for developers and MUDs.

Fourth, the industry professionals that provide services to MUDs are central to their success and continued use. There is a large collection of engineers, utility operators, certified public accountants, lawyers, financial advisors, developers and homebuilders with vast experience in setting up and maintaining MUD operations. This group helped establish MUDs as the primary growth vehicle for Greater Houston and helps maintain its role in the region.

MUDs and the subdivisions they support have drawn residents for decades. MUD subdivisions can provide lower home prices because the MUD structure allows the costs of infrastructure to be paid off over time through tax-exempt bond debt service rather than recouping it in the price of the home. Residents pay the debt service with their property tax. One advantage of this approach for residents is that their tax rate can actually be reduced over time as the debt is paid off. Usually, after starting at a higher level the tax rate is reduced and maintained at a level that permits the MUD to maintain its infrastructure.

In addition to lower prices, MUDs are attractive to residents who want to move away from the taxes and regulations that come from residing in an incorporated city and to what they perceive as better schools in suburban school districts. Similarly, residents often applaud the responsiveness of MUDs to their needs and the ability to see where their tax dollars are being spent. Finally,
Average Tax Rates by Year of Formation

Tax Value per Tax Year (not adjusted for inflation) 1986–2015

General Obligation Debt (2015)

Aggregate Outstanding Debt in MUDs Located in City of Houston ETJ
when MUDs transition from developer-managed to resident-managed, those living in the districts are given authority over the MUD, its operations and finances, a form of local control that is appealing to many.

MUDs are usually created at about the same time that a development is planned. Typically, a developer contracts with MUD industry professionals to help create the MUD. Then, via a developer finance agreement with the MUD, the developer advances the funds required to engineer, bid and build the infrastructure needed for future homes in the development project. The developer is reimbursed for a certain amount by proceeds from tax-exempt bond issues only after putting value in the form of homes and infrastructure on the ground. The bonds are pledged for payment from ad valorem property taxes generated by property within the MUD. This reimbursement process is quite different from other payment systems used in other land development financing tools. In many other cases, developers can get an upfront payment or incentive based on raw land value. MUDs shifted away from this approach in the 1980s.

The process of creating a MUD can be pursued in two ways: approval by the Texas Commission on Environmental Quality (TCEQ) or through the state legislature. The legislative route has been used more frequently in recent years because it can progress more quickly and because more powers are available to MUDs through the legislative process.

The TCEQ route exists because of MUDs’ initial role as an entity to provide and control water and wastewater for developments. As a result of many problematic raw land deals and a declining economic situation in the 1980s, TCEQ was also given a variety of oversight powers related to bond issuance feasibility and infrastructure construction procedures.

To initiate the creation process through the TCEQ, a developer petitions for the creation of a MUD. If the proposed MUD is in a municipal ETJ, the city must approve. Once approved, the TCEQ appoints an initial board, recommended by the landowner or its contracted industry professionals. That appointed board is eventually subject to general elections and replacement through those elections.

To create a MUD via the legislative route, a sponsoring legislator submits a standalone bill that describes the boundaries and powers of the proposed district. Most legislation directs the landowner to submit a temporary board of directors to the TCEQ and compels the agency to appoint that recommended list of the initial board members. Once the MUD is created and the board appointed, a confirmation election is held among residents of the district to elect the board members and approve the principal amount and type of bonds that can be issued by the MUD.

In some cases, since the MUDs are undeveloped, the residents are parties moved into the district by the developer for the purpose of voting in the election and approving bonds. For MUDs within a city’s ETJ, the legislative route usually prevents the sale of bonds until the municipality approves of its creation.

Over the past 30 years, the value created in MUDs in Houston’s ETJ has grown tremendously. As Figure 9 shows, MUDs’ taxable value reached a peak value of $123 billion in 2015, the last year that in-depth statistics are currently available. Collectively, the ad valorem tax values in the districts provide a huge amount of tax revenue to the county and other local jurisdictions.

While MUDs possess a huge amount of value, they also hold significant debt. The debt is critical to their functioning since it is what allows developers to be reimbursed for their upfront infrastructure costs. MUDs in Harris County hold more outstanding general obligation debt than either the City of Houston or Harris County. As of 2015, the MUDs held $3.9 billion in general obligation debt. At the same time, the City held just over $3 billion and the County held $2.5 billion (Figure 10). These figures are limited to general obligation debt, both the City of Houston ($12.4 billion total) and Harris County ($6.4 billion total) hold significant pension and other debts. Most MUDs are solvent and financially stable. MUD bond debt is highly rated, with many MUDs having a credit rating at par or better than some cities. Also, unlike the debt of cities that can be tied to escalating costs such as pensions, MUD debt is almost all limited to infrastructure construction and maintenance.

Most MUD debt is held by districts inside of Harris County, but if you include all districts in Houston’s ETJ, which hold nearly $1.9 billion in debt, the total rises to just under $5.8 billion in outstanding obligations (Figure 11).

Technically, MUDs are a type of water district. While there are 15 distinct types of water districts in Texas, MUDs are by far the most common and influential. There are 960 active MUDs in the state as of 2018. This is more than all other types of water districts combined. MUDs are so pervasive that many of the other districts have, as a part of their enabling legislation, the ability to convert into MUDs. Figure 12 shows the current status of water districts across Texas in 2018. Dissolved districts are those that have either been annexed or not developed.
Water districts were created in 1917 as vehicles to expand and support agriculture and rural land development, a role they primarily filled until World War II. As Texas’ population expanded rapidly in the postwar period, though, the districts became a tool that could help create and provide infrastructure for growth outside of municipal boundaries. In the 1950s and 1960s, water control and improvement districts were used heavily. MUDs were first created in 1971.30

Postwar urban and suburban growth fostered an annexation competition in Texas’ major metropolitan areas. Houston conducted several huge annexations to bring its suburban growth onto the city’s tax rolls. In 1948, the city annexed 84 square miles. In 1956, it annexed 185 square miles.31

As competing jurisdictions moved to bring new growth into their tax base, the opportunity to develop outside of cities became more attractive. Developers began to use water districts more and more, knowing that cities would annex their subdivisions eventually. Competition to annex desirable areas became so intense that in 1963, the Texas Legislature passed the Municipal Annexation Act (MAA). The law established annexation rules that favored large cities such as Houston, San Antonio and Dallas by allowing them to annex more territory than smaller cities and to control development up to 5 miles outside of their city limits by creating an expansive extraterritorial jurisdiction.32 Part of the logic of creating ETJs was that cities would apply development rules and regulations to new developments consistent with the city to which the ETJ area would eventually be annexed.

Between 1951 and 1970, the number of water districts in Harris County grew from 19 to 133.33 Figure 13 shows the date of creation for all existing non-MUD water districts in Harris County. (Districts that dissolved upon annexation are not shown.) 105 non-MUD water districts, mainly water control and improvement districts and levee improvement districts, remain in operation today within the Houston ETJ. These entities hold $36 billion in taxable value and nearly $1 billion in debt.

In 1971, MUDs were authorized by the legislature and became the most common form of a water district. By the end of the 1970s, the number of water districts in the Houston area skyrocketed, reaching 327, with most of that growth coming via MUD creation.34 In the first decade they were allowed, more than 140 MUDs were created in the Houston ETJ in the 1970s.35 (See Figure 17 for the number of MUDs created in each decade since 1971.) Figure 14 shows the MUDs created in the 1970s. The districts shown are just those that exist today; this map does not include the small number of MUDs annexed by the City of Houston or dissolved for another reason.

During the 1970s, large cities like Houston annexed with regularity as the MAA intended, bringing MUDs into the city and taking over both the MUDs’ outstanding debt and overall service provision. The central role that MUDs currently hold in the governance structure of the Greater Houston region is due in large part to the breakdown of this once robust annexation program.

Houston maximized the benefits of the MAA by annexing 10-foot-wide strips within the rights-of-way of the region’s radial freeways (where no city services would be required) and then claimed 5 miles to either side of those strips as its ETJ. This only worked where there were no smaller cities “in the way,” which tended to be in a northeast to southwest arc around Houston. These moves resulted in Houston’s unique city limits today, which appear to splinter across the region. It also allowed Houston to establish veto power over much of the region’s growth through its power to approve or block new MUD formation and incorporation. By the late 1970s, though, large-scale annexation by the City of Houston came to an almost complete stop.
Harris County Non-MUD Water Districts by Decade Created

FIGURE 13

Date of Formation
Decade
- 1970s
- 1990s
- 2000s
- pre-1970

Source: Municipal Information Services, 2016 Data for Tax Year 2015; TischlerBise analysis.

NON-MUD DISTRICTS
HARRIS COUNTY, TX
THE GROWTH OF MUDS AND SHIFTING ANNEXATION PRACTICES

FIGURE 14

ETJ MUD Formations in the 1970s

Houston Region Boundaries

MUDS in Houston’s ETJ Formed in the 1970s

Source Data: City of Houston, Created By: Matthew Krause

Created: 12/17/2018
FIGURE 15  ETJ MUD Formations in the 1980s
FIGURE 16  Existing MUDs in Houston ETJ, 1970–2009
Houston slowed its annexation for three reasons.

First, the expense of providing full services and assuming the debt for annexed areas was high. As providing services to a huge city became increasingly costly in the 1980s, the annexation equation flipped, with most annexations likely to cost the city more in service provision than it would collect in taxes.

Second—related to the first—MUD residents satisfied with their level of service saw little reason to pay higher taxes after annexation and so fought any proposed moves. For residents of MUDs with declining tax rates, the case for supporting annexation became increasingly harder to make. If residents were content with their level of service on things like solid waste and law enforcement (in Harris County, these services were usually provided through a contract with either the Sheriff or a Constable), then there was little reason to join a city and pay higher taxes.

And third, the city was concerned about violating the Voting Rights Act, a major tenet of which is to prevent annexations that could dilute the power of non-white voters. The VRA was used to sue the City during its annexation of Clear Lake City in the late 1970s. Houston fended off the lawsuit by shifting its city council to a single-member model, which satisfied the VRA by giving direct representation to minority groups. Ultimately, Houston annexed Clear Lake City over the objections of residents. But the fight around Clear Lake City and the threat of additional VRA lawsuits slowed the city’s appetite for large annexations.

As annexation became politically more difficult, especially for the City of Houston, MUDs began to live past their expected operational lives and become a quasi-permanent form of government. Partially in response to this, during the 1980s, the legislature gave MUDs additional powers, such as limited road-building, on an ad-hoc basis. During the 1980s—the first decade in which major annexations did not occur—more than 100 MUDs were formed in the Houston region (See Figure 15 and Figure 17).

However, the sudden slowdown in annexation by Houston meant that the blossoming districts had no municipal safety net. Developers began to sell MUD bonds before taxable value in the form of homes or infrastructure had been created on the ground. When the recessions of the 1980s struck, the MUD system nearly broke down. With the oil bust that began in 1983, Houston’s economy slowed significantly, which impacted the growth and sales across the region, including those in MUDs. The subsequent savings and loan crisis of the late 1980s saw the failure of hundreds of banks that had bet big on real estate. These double blows led to the defaulting of over-leveraged MUDs. Eighteen Texas MUDs defaulted between 1987 and 1994, of which were in the Houston region. In some instances, MUDs raised their tax rates to unsustainable rates. In a few cases, property tax rates ballooned from $1.00-$1.50 to $30 per $100.
Amidst this crisis, the Texas Legislature established a number of ways to monitor debt financing systems. For example, the state created the Texas Bond Review Board, which brought greater scrutiny to all debt financing in the state. The legislature also nearly shuttered the water district system entirely. However, developers and investors worked with the legislature to incorporate a major series of reforms into the MUD system.

By giving the Texas Commission on Environmental Quality and its predecessors greater oversight power and adding a number of regulations to the Water Code to reduce the financial risks MUDs could take on, these reforms stabilized the MUD system and since their implementation, few MUDs have gone bankrupt and most that defaulted have recovered.40

Overall, the reforms moved financial risk from the MUD to the developer and ensured a rigorous financial review. The changes included:

- Preventing the sale of bonds on anticipated value.41 Homes and other improvements equal to 25 percent of the total bond amount must exist before reimbursement.42
- Requiring developers to install all water, drainage and street infrastructure before receiving any reimbursement.43
- Requiring more robust market studies and financial oversight.44
- For bond feasibility only, setting a maximum property tax rate of between $1.00 and $1.50 per $100 of value, depending upon where in the county the MUD was located.45
The formation of new MUDs dropped considerably in the early 1990s as the economy recovered. Only 21 MUDs were created in Houston’s ETJ in the 1990s.

The annexation of Kingwood and its MUDs by the City of Houston in the late 1990s was the final major annexation move by the City of Houston and it highlighted the resistance of MUD residents to the idea of paying higher city taxes.

Kingwood residents worried that Houston’s services would be worse than those provided by existing MUDs because they would be subsidizing city spending in areas outside of Kingwood. Residents also fought the annexation on the grounds that they would lose political representation and responsiveness by moving to such a large municipality.46

While the city ultimately annexed Kingwood, the Texas Legislature used the fight as rationale for the passage of a new law in 1999. That law required annexing cities to create annexation plans providing earlier notification of intent to annex and ensuring that services in the annexed area would not be reduced in quality.47

By the 2000s, the creation of MUDs picked up the pace again, while annexations in Houston stopped almost completely. More than 90 MUDs have been created since 2000—almost all of them prior to the 2008 recession. Only one MUD that is currently active was formed between the 2008 recession and 2014 in the Houston ETJ. The reforms of the 1980s were tested by the Great Recession and no MUDs have defaulted since 2008, proving the financial stability of the system. Figure 16 displays all the existing MUDs formed within the Houston ETJ broken into five-year periods. Figure 17 shows the overall trend in MUD formation for each five-year period.

In-city MUDs

While most MUDs are created in suburban areas, they can also be created within municipal limits. An in-city MUD is created via the same means as one in the ETJ and operates under the same financing and oversight mechanisms: the developer builds infrastructure up front, the district issues bonds to pay the developer back and residents pay off the bonds with an additional property tax levied by the MUD. In practice, this tool is used to spur development in either an undeveloped portion of the city or in areas where typical tax-increment financing vehicles would be unlikely to produce much revenue.

The City of Houston and other surrounding cities have allowed this type of MUD on a few occasions. For the cities, it provides a way to have infrastructure built at little to no cost to them. For Houston, which is limited in its property tax collection by a revenue cap, the in-city MUD provides a way to build infrastructure it could not otherwise build with its own funds.

The City of Houston currently has 37 MUDs within or overlapping with its city limits. These entities cover approximately 25 of the city’s 600-plus square miles and hold about $380 million in debt. There are several in-city MUDs south of downtown along State Highway 288 and others are scattered near the George Bush Intercontinental Airport, near Addicks and Barker reservoirs and to the southeast toward Hobby Airport.

Case Study: City Park

Comprised of 1,500 homes on 375 acres, City Park is the result of an in-city MUD pursued by city planners with a developer. Built on vacant farmland south of the Texas Medical Center, the neighborhood was designed to house residents employed at the TMC with lower home prices and encourage retail businesses and development in the surrounding area.

At a cost of $250 million, the development would not have been feasible without reimbursement via a MUD or pricing of homes at substantially higher costs to recoup initial outlays. The developer undertook the development with the pledge of reimbursement, city planners estimated an additional $1.5 million in city property taxes within eight years and residents benefitted from purchasing homes with lower initial prices.

The area around the development has also benefited. As the development began to take off, investors purchased land around the neighborhood. Likewise, the City of Sugar Land has permitted the creation of in-city MUDs because, in the eyes of the city, they are far more likely to get high-quality development through a development agreement with a MUD. This allows a city and a special district to agree to a set of standards and plans then if they let land development happen on the open market. Without the MUD, the city would also have to pay for infrastructure development. In the case of the Sugar Land in-city MUDs, the development agreements set out what services are provided by each entity.
Although it has annexed almost no new territory in the past 20 years, the City of Houston still controls development in parts of five counties because of its expansive ETJ. Almost all the development that has happened within the ETJ has occurred within MUDs, but the City must approve of all MUD formations and, through its planning commission, approve of all plats and standards in every development. The City has also used limited purpose annexations, described further below, to access sales tax in certain MUDs. The City has effectively made it so few MUDs have the possibility to either incorporate on their own or annex to another city. A few exceptions to this are the city’s 2007 agreement with The Woodlands to not annex the area and Houston’s release of part of its ETJ in Katy around the Katy Mills Mall.

Houston has good financial reasons to resist full annexation. The service provision costs remain high and the absorption of outstanding debt, even of close-in MUDs with lower average debt, would be crippling to the city’s budget.

Concerns about the Voting Rights Act likely have less impact on annexation decisions at this point. The United States Supreme Court struck down key provisions of the VRA in 2013 and the Greater Houston region’s suburban areas are more ethnically diverse than earlier decades.48 At the same time, however, changes to the state’s annexation laws in the 2017 legislative session are likely to circumscribe annexations even further. Senate Bill 6, which was passed in the special session, requires an annexation to be approved by a vote or petition of those being annexed. The vote provision applies to any annexation process initiated by a city within a county that has more than 500,000 people, meaning it already applies to Harris, Fort Bend and Montgomery counties.49 The law is a challenge not just for large cities, such as Houston, but also smaller, growing communities such as Conroe or Pearland.50 An exception to the current law is that in areas with strategic partnership agreements in place—which often lay out terms for a planned annexation—annexation can occur without a vote per the terms of the agreement.

Three other elements critical to the current annexation dilemma require further explanation.

- Strategic partnership agreements
- Limited purpose annexation
- Patchwork annexation

**Strategic partnership agreements**

Since 1995, cities have been able to enter into strategic partnership agreements with a MUD.51 SPAs establish a clear set of timelines and expectations for the annexation of a MUD. In the case that the SPA is a prelude to a full annexation, the SPA lays out exactly what services will be provided by each entity and how costs will be split over...
time. In these cases, they also determine a clear annexation date. They can, though, also be used to create a limited purpose annexation, which is explored further below.

SPAs are often done in conjunction with development agreements, which allow the city to work with the developer of a new community to lay out clear guidelines and expectations for the final shape of a development including land use, amenities and infrastructure. The combination of an SPA and development agreement means that a city can help shape a development from initiation through completion in partnership with both a MUD and a developer. While the City of Houston is fully empowered to use SPAs within its ETJ, it cannot craft development agreements with landowners in its ETJ.

The SPA process represents one of the most likely ways for future annexations to occur under the rules of Senate Bill 6 because the carve out in the bill allows for areas with an SPA to be annexed without a vote. As will be explored below, cities have many existing SPAs. The City of Houston has 227, for example, and these agreements likely offer one of the only ways for the City to annex in the future. This approach creates a win-win situation for MUDs in unincorporated areas and annexing cities by laying out plans to bring the tax rates and services offered by the two entities into line over a number of years before annexation. They also help create greater buy-in from residents and the annexing city alike.

Through the use of SPAs, smaller cities such as Sugar Land have seamlessly annexed neighboring developments into their municipal boundaries. The city requires that MUDs pay full price for certain services provided by the city. Additionally, most SPAs allow the city to start collecting sales tax and some other limited revenues with an eye toward easing eventual annexation. Sugar Land uses the sales tax it collects in SPA areas to pay off any outstanding MUD debt upon annexation, to maintain public infrastructure within the MUD ahead of annexation or as a stopgap to ensure the city can afford to pay for additional services within the MUD before annexation brings in property taxes.

**Limited purpose annexations**

As mentioned above, an important subset of SPAs are limited purpose annexations that can be pursued in a city’s ETJ. LPAs allow cities to annex smaller portions of unincorporated areas, usually commercial strips, with the intent of collecting sales tax revenue but not fully annexing them or providing them with services.

Cities may collect a 1 percent sales tax on top of the 6.25 percent collected by the state. In unincorporated areas without additional taxing entities such as a transit agency or an emergency service district, this additional sales tax is simply not collected. Under a limited purpose annexation, however, a city and a MUD create an agreement that allows the city to collect the additional 1 percent sales tax and share it with the MUD. In return for sharing the sales tax, the city usually agrees not to annex the MUD for a set period of time, usually 30 years.

As the City of Houston has ceased general annexations, it has moved heavily toward creating LPAs with MUDs and other special districts. This has allowed the city to access sales tax revenue without providing major services to these districts over the short- and long-term. The pursuit of these agreements is often framed by the city as a commuter tax, aimed at collecting revenue from residents who live outside of Houston but who use the services provided by the city. In these agreements, the city typically annexes only existing or future commercial centers and collects sales tax in those areas. They then agree to split that revenue 50-50 with the MUD. The city is not required to provide any additional services within the LPA and in most cases, the MUD simply continues to provide services and infrastructure it was already providing.

In FY 2017, the city collected $106.6 million in sales tax across 227 LPAs, meaning the city and the special districts involved received approximately $53.3 million each. In FY 2017, 187 LPAs were with MUDs, from which the city collected more than $88 million in revenue, resulting in $44 million going from MUDs to the city and the remaining $44 million split among the MUDs. MUDs often use this funding to pay for law enforcement contracts.

The LPA approach, though, does not include counties. Under a full annexation, the city brings a territory into the city, provides full services and collects sales and property taxes to pay for them. Under an LPA, the sales tax is collected and split between the city and district. The county still provides services within the limited annexed territory—especially road and stormwater maintenance—but is not given access to any of the collected sales tax.

Finally, as Figure 18 shows, with the tax year 2017 LPAs, Houston has effectively surrounded itself with LPAs. Under current LPAs the city is unable to annex these entities. If, when the current agreements expire, the City of Houston and its partners were to reform the underlying SPAs to move toward full annexation, it would open a path for the city to grow in a planned partnership with MUDs.
CURRENT ANNEXATION POLICY AND ITS IMPACT ON MUDS

FIGURE 18  MUDs and LPAs FY 2017

Houston ETJ LPAs (FY2017)

- MUD
- Non-MUD

Sources: Esri, HERE, DeLorme, USGS, Intermap, Increment, NRCan, Esri Japan, NAVTEQ, Esri China (Hong Kong), Esri Korea, Esri (Thailand), MapmyIndia, NGCC. © OpenStreetMap contributors, and the GIS User Community
If the LPAs are renewed without a move toward annexation, the veritable ring of LPAs would make any potential future annexations for the City of Houston unlikely.

A similar arrangement to LPAs are industrial districts. In these arrangements, a city agrees with an industrial property owner to not annex for 15 years in exchange for an annual payment that is equivalent to a portion of the taxes the city would collect under a full annexation. The collection rate on the land value is the same as a full property tax rate under annexation, but the rates for improvements and new construction are lower under such a district. The city also does not require permitting within the districts for any new improvements.

**Patchwork annexation**

A final issue shaped by both past and current annexation practices is the skipping over of areas deemed less desirable, such as those holding little property value, high service needs or lacking potential for producing sales tax income.

In many cases, cities like Houston have simply not annexed these areas because the service costs outstrip the property tax value. Likewise, developers have little incentive to target such areas for planned developments, so few have MUDs in place. Creating a MUD over the top of an existing neighborhood is not feasible.

This reality has created a patchwork of areas serviced interchangeably by cities and counties. One of the best examples of such an area is East Aldine. The mostly working-class, Hispanic community to the northeast of Houston was jumped over when Houston annexed the area that is now the George Bush Intercontinental Airport. East Aldine remains separate from, but almost completely surrounded by, Houston. The area receives no services from the city. East Aldine receives services from the county and it has a management district that has been using its 1 percent sales tax assessment to improve infrastructure—particularly to address the area’s reliance on septic tanks—but the maintenance and updates needed to the area’s system outstrip the current means of the district. Districts such as East Aldine can also access federal Housing and Urban Development community development block grant funding through the county.
Not all areas have management districts as East Aldine does. Many areas of the county—most of them lower income—are unlikely to be annexed by either a municipality or brought into a neighboring MUD because the annexing entity and its residents would likely view such a move as a subsidy to the areas with lower property values, fewer resources and more maintenance needs.

**Governance**

MUDs have been criticized for not being as transparent as other units of government. In recent years, the Texas Legislature has put new rules in place to create greater transparency and increase available public information.

Each MUD is governed by a five-member board. Throughout the life of a MUD, the board operates as the primary manager for the entity. The board sets the tax rate and contracts with support professionals, usually including a utility operator, bookkeeper, auditor, attorney and engineers. With the support of these entities, the board is responsible for directing all construction, maintenance and financial duties of the MUD. Using contractors, in lieu of full-time staff, helps reduce pension and other liabilities held by MUDs.

The initial MUD board is appointed by the TCEQ or the legislature, depending on how a MUD was created. The initial board of directors is usually selected from a list suggested by the developer or industry professionals involved with the MUD. While there are rules in place to limit conflicts of interest—no direct family members of developers, for example, can serve on the board—common practice is for developers or their agents to suggest members whose interests align with their own. Eventually, the appointed board is replaced via election with a board that must consist of property owners or residents of the district.

MUDs are often criticized because the initial appointed board decides on the infrastructure projects and sells the bonds, while the later board—elected by residents—must levy taxes to meet the bond payments but in many cases has no influence on those earlier debts. While, to a certain extent, MUD boards act as all governing bodies act by making decisions about current and future needs, the fact that the bonds they approve are used to reimburse private developers makes existing efforts to ensure transparency merited.

When residents buy into the MUD, they receive a set of documents that detail what the debt and tax liabilities are. But since questions persist about the availability and clarity of this information, efforts to improve that notification system and access to that information should continue.

Further, ensuring that residents taking leadership positions on the board or that might take leadership positions on the board are prepared to deal with governing the entity is essential.

General access to information about MUDs has been a big enough issue in recent years that in the 2017 session of the Texas Legislature, Senate Bill 625 created the Special Purpose Public Information Database. This database requires every special district to submit annual financial information and list its board members and contracted parties. The justification for the bill was to provide an educational and informational tool for residents.

In most cases, the transition between an appointed MUD board and resident-run boards is executed well. The Association of Water Development Boards provides a range of trainings for resident-directors and the professionals contracting with MUDs to help to manage the transition and training of resident-directors. However, additional educational support for residents to learn about MUDs and their functioning could benefit all involved.

While the residents on the board may have good knowledge of how the system works and what their responsibilities are, those considering joining the board or those who simply want to better understand its functioning would benefit from additional training or available information.

Similar to MUD boards, HOA boards have earned the ire of many residents for being opaque in their governance and management of communities. Transparency was a big enough issue, that, in the early 2000s, the Texas Legislature passed a law giving residents more access to information and forcing more open meetings. Complaints about the unfair collection of fees and even foreclosure proceedings to collect HOA fees have kicked up controversy around the boards for years as well.
Options for Reform

Within the current regional governance system, there are a variety of opportunities to find efficiencies, address transparency issues, shore up revenue shortfalls, improve equity and secure a shared vitality of the region.

Options for addressing existing issues and challenges facing cities, counties and special districts within our regional governance system are introduced in two categories, roughly presented here in order from the most politically difficult to the easiest. Considered first are structural reforms to the current system, which introduce new governance structures and statutory reforms. The second set of options introduces opportunities for increased collaboration between MUDs, cities and county governments.

The options below should be seen as a set of possible approaches. No one option is being touted as a silver bullet. These options could be pursued jointly or independently.

1. Structural Reforms
   1-1. Regional Reforms
   1-2. County-Level Reforms
   1-3. City-Level Reforms
   1-4. General Reforms

2. Increased Collaborations
   2-1. City, County and MUD Collaborations
   2-2. MUD to MUD Collaborations

1. Structural Reforms

Most of the reform options in this section would require legislative action to make statutory changes to existing state law.

1-1. Regional Reforms

A. City-county consolidation

Consolidating the City of Houston and Harris County government would be a more heavy-handed approach to achieve an outcome of fiscal regionalism, i.e., adopting a regional approach to collecting and funding government operations. While this approach would not directly address the issues around special districts, it would reduce the number of jurisdictions operating in the region and potentially significantly shift the use of ETJs.

Under a consolidated county government, smaller cities and special districts could either remain independent or be annexed into the consolidated government, either immediately upon formation or later on.

Consolidating the two largest governments in the county into a single entity would introduce a single accountable actor for all infrastructure and regional planning, along with providing a single pot of revenue to pursue the plans.

While full consolidation is unlikely in Houston for numerous reasons, including the fact that Houston’s city limits stretch into three counties, smaller steps toward consolidation or formal county-level partnerships should still be explored by the local governance system.

Special districts would not necessarily have to be eliminated in this scenario. Special districts, including MUDs, could still operate within the consolidated government. Districts and smaller cities would have the option to join the consolidated body if they chose to do so.
B. Implement regional revenue sharing

Because local governments are geared toward serving their constituents, it can be difficult to find ways to address regional challenges. Approaches that allow a region to act collectively and support neighboring jurisdictions on pressing needs, while still maintaining local control, can help overcome this issue.

One approach is to adopt policies that enable the collection of a portion of revenues from across several regional jurisdictions into a pool to create a revenue-sharing model. Indeed, this was part of the original rationale for the creation of large central cities—ranging from New York to Los Angeles to Houston. A single large jurisdiction allows the region to pool its resources to provide service provision in an efficient and equitable way.

Sharing revenue without consolidating jurisdictions is an alternative. In this model, local governments contribute a portion of their tax revenue to a shared pool of funding. This funding is then either distributed across the region to jurisdictions with funding and services gaps or used to address regional challenges. Further, this model is often used for economic development and equitable funding of regional facilities and functions located in one jurisdiction but used by residents throughout the region. But the basic structure and powers of the existing local government are not altered.

A revenue-sharing model could be created throughout the Greater Houston area, including multiple counties. This approach could help eliminate funding and service disparities throughout the region and aid regional growth, planning and development. The governance structure could follow the region-wide appointed board and chair from the state, similar to the Minnesota Twin Cities Metropolitan Council, described on the right.

Pros:

- Helps address service equity concerns across multiple jurisdictions by supporting areas with less revenue.
- Improves regional economic health by supporting the efforts of local government with less revenue to provide services or create development.
- Creates a mechanism to prioritize and fund solutions to regional issues.
- Removes incentives for municipalities to chase tax base, creating an opportunity for growth and development to be planned at a regional level.

Case Study: Minnesota’s Fiscal Disparity Program

Probably the best-known program of revenue sharing is the Minneapolis-St. Paul Fiscal Disparities Program, a product of the Twin Cities Metropolitan Council. The program was an innovative attempt to address growing fiscal concerns within the seven-county Minneapolis-St. Paul region, home to 186 cities, villages and townships, 48 school districts and 60 other taxing authorities. The law took effect about 40 years ago and requires all communities in the seven-county area to contribute 40 percent of the growth in their commercial-industrial tax base to a regional pool. The idea was to reduce the disparities between the “haves” and the “have-nots”—communities with a lot of commercial-industrial property and those lacking in such development. The two main goals of the program are: promoting more orderly regional development and improving equity in the distribution of fiscal resources. More communities gain from the shared tax base (99 net recipients) than lose tax base (80 net contributors).

Notably, the idea was not the result of an overnight decision. Rather, the idea grew from the Citizens League, a group of business- and civic-minded individuals in the area that organized groups, breakfasts and seminars highlighting persistent regional issues in the 1960s, until a consensus developed in 1967 for a metropolitan council. Once approved, the 16-member board and chair appointed by the governor, subject to state senate approval, gave the council an unprecedented political base in the state legislature.

It is also worth noting that “donor” and “recipient” jurisdictions have changed over time. In the 1970s and 1980s, when the revenue-sharing system was new, the central cities of Minneapolis and St. Paul were recipients, while inner suburbs were donors. Decades later, as the growth dynamics of the region changed, the positions reversed—the central cities are now donors and the inner suburbs are recipients. This experience suggests that a revenue-sharing system can create a more sustainable fiscal situation for local governments not only across geography but also over time. Winners and losers are not necessarily permanent, they can change over time.
Addresses the issue of residents in unincorporated areas who use city services while avoiding city taxes by having them contribute to the shared pool.

More appealing than a city-county consolidation form of governance because municipal governments remain autonomous.

Cons:

- Politically difficult, would require all local governments to agree to cede a portion of their revenue to the shared fund and require state approval.
- Little public support for fiscal regionalism if the regional needs do not capture the general interest of the public.
- Loss of local revenue for wealthier communities and places where growth is concentrated.
- Logistically difficult. Would require the creation of a regional body responsible for distributing the shared-revenue. Would also need to decide how special districts contribute to the system.
- The long-term nature of the effort could affect perceptions of it as a waste of money or ineffective.

1-2. County-Level Reforms

A. Create an urban county designation

Counties that contain quickly growing metropolitan areas are increasingly expected to provide municipal-level services. However, counties are not situated with either revenue streams or ordinance powers to ensure they can provide this level of service. This reality limits what counties can do to encourage or shape development.

One way to address the limitations of the county government would be for the Texas Legislature to adopt an urban county designation within local government code, which would effectively give high-growth counties the powers of a municipality in their unincorporated areas. This would give the county ordinance power and could allow it to collect up to 1 percent sales tax in unincorporated areas, among other capabilities. In effect, the county would become the primary municipal government, providing sanitation, water, streets and public safety services. Ordinance-making power would allow the county to address issues around regulating development, nuisances and public health.

Again, special districts and municipalities would not be mandated to join the new entity, but could choose to annex into it. In the case of the dissolution of any MUDs or cities, a clear service plan would need to be in place to ensure residents do not experience a decline in service.

Another challenge would be ensuring that if county taxes are collected from municipalities under this designation that services and infrastructure be rendered within those cities.

This would require the adoption of an urban county government structure in the Texas Local Governance Code, which would be politically contentious and difficult. Indeed, only Arlington County, Virginia—a much smaller county than Harris County—has adopted this form of governance in the United States (see case study).

Case Study: Arlington County

In the Washington, D.C. metropolitan area, Arlington County and the City of Arlington were roughly equal in size but with stark differences in statutory powers—paralleling the state of Harris County and the City of Houston today, though the sizes of the two examples are vastly different. The urban county has a land area of 26 square miles and a population of over 200,000 residents.

Rather than consolidate all the levels of government, all the unincorporated areas of Arlington County became incorporated under an Urban County Executive form of governance, with the opportunity for cities in the County to petition and become part of the County. Essentially, Arlington remained a county but gained the powers of a city.

Pros:

- Public services are centralized and standardized across unincorporated areas.
- Urban counties gain sales tax collection and revenue to provide additional services.
- Urban counties gain ordinance powers to better manage unincorporated areas.
- Municipal governments inside the county remain autonomous, with an option to later join the urban county.
- New governance model provides a path for other counties, which might urbanize, to better fund services.
Cons:

- Perceptions of declines in the level of service because of a larger municipal government.
- Politically difficult because it requires the governance model to be added to the Texas Local Government Code.
- Smaller municipalities and special districts may resist joining, reducing the benefit of the realignment.
- Public support might be difficult to secure if regional issues are not in the general interest of the public.
- Smaller municipalities and special districts may resist joining, reducing the benefit of the realignment.
- Sales tax collection would be complicated by emergency services districts and limited purpose annexations.

B. Give urban counties sales tax power and raise sales tax cap

The first of two smaller subset options of the “urban county” model would be for the state to give high-growth, urban counties the ability to collect sales tax and raise the sales tax cap within those counties. These counties are currently prevented from collecting sales taxes because they possess transit authorities. Simply giving counties the ability to collect sales tax under the current cap would do little to raise revenue since most areas have reached the cap.

Giving high-growth, urban counties the ability to collect sales tax and also raising the overall sales tax cap to 9.25 percent in those counties would allow the county government to collect more revenue to provide public services and amenities to its entire jurisdiction. The additional sales tax revenue could also be designated for certain uses such as infrastructure maintenance.

If pursued separately from ordinance-making powers, this revenue could be used to support existing costs associated with maintenance of roads and storm sewers across the county, including inside cities. Additional revenue would allow counties to keep up with growth-induced demand.

Pros:

- Increases county revenue to pay for expanding maintenance costs.
- Does not raise property taxes and the impact is negligible to most communities.

Cons:

- Politically difficult in an anti-tax environment.
- New revenue would not necessarily be dedicated to existing service needs.

C. Give counties ordinance-making powers

Because counties are organs of the State of Texas and not home-rule entities like cities, they do not possess ordinance-making powers. They are able to act only through whatever powers the state affords them. For many rural and smaller counties, this has not presented an issue. The major powers afforded to the counties suffice in these situations. However, urban counties confront a slew of issues not accounted for under current state law and find themselves limited in how to respond.

Providing ordinance-making powers to urban counties would give these entities the flexibility to respond to a range of issues around development and growth, public health, dilapidated and vacant structures, nuisance complaints and other public safety needs. It could also be used to allow the county to provide other services not currently available such as solid waste collection.

One moderated option around ordinance-making power would be to give counties limited ordinance-making and service delivery powers. Such an approach could be used to ensure counties have the ability to respond to development and growth pressures, as well as to address infrastructure, public health and public safety needs, without giving them carte blanche to pass ordinances on all matters.

Pros:

- Allows the county to more appropriately respond to challenges of governing a high-growth, urban area.
- Gives more oversight to development and service provision outside of municipal boundaries.
- Limited ordinance-making power would give the Texas Legislature ability to carefully define areas of county power.

Cons:

- The perception that new regulatory powers would create another layer of bureaucracy or restrict residents within unincorporated areas.
- Requires a huge shift of state law and policy toward counties.
- Public perception of new regulations could damage public support.
- Opposition from cities that would lose control of ETJ regulations.

D. Reform limited purpose annexations to ensure counties benefit

As currently constituted, limited purpose annexations cut counties out of accessing the revenue they create. Only cities and the districts they enter into an agreement with share the sales tax collected through these tools. Counties do not benefit from these arrangements, except when MUDs use the revenue to pay for services such as law enforcement, even though they must provide some services inside MUDs that have agreements with cities.

Counties could gain access to this revenue if the state mandated that cities and MUDs share revenue collected from LPAs where annexation is not the ultimate plan. For example, such LPAs could be operationalized to split the sales tax three ways between the city, county and MUD or split it between city and county for services rendered within the district.

Alternatively, LPAs could be rolled back where annexation is not the ultimate goal. Instead, County Assistance Districts could be promoted. This tool would give revenue to the county, but only to be used in addressing needs within the district.

Pros:
- Splitting LPA revenue would generate revenue for a county to address systemic issues in unincorporated areas, while not removing revenue completely from a city or MUDs.
- Reforming LPAs would encourage limited purpose annexations to be used to pursue full annexation, not simply the collection of sales tax.

Cons:
- Reduces revenue for the City of Houston and discretionary funds to MUDs.
- Politically difficult because the city and MUDs are currently winning and the county losing. Any shifts would threaten that alignment.
- Public support for a change would be weak if their general interests do not align with the growing costs the county faces.

- Removing LPAs would likely terminate the SPA cities and MUDs have, threatening the chances of future annexation under current law.

1-3. City-Level Reforms

A. Reform ETJs for large cities

Large cities command huge ETJs and effectively control all development within those areas. For example, the City of Houston must approve any incorporation or development within large swathes of Waller County.

As stated above, further annexation by the City of Houston is not likely. Instead, the State of Texas could consider reforming ETJ rules to either eliminate the expansive nature of large cities’ ETJs or to compel cities to realign their existing ETJs into a more rational form.

This could be achieved through any of several approaches:

1. Setting a lifespan for the use of ETJs
   
   Under this approach, a city would have to establish a clear plan for the annexation of its ETJ within a set period of time. If no plans are in place, a city would have to release that section of the ETJ to be claimed by other municipalities.

2. Negotiating the release of ETJs to neighboring cities
   
   Smaller cities that are looking to expand are currently hamstrung by larger cities’ control of the ETJs. Larger cities should be encouraged to release far-flung portions of their ETJs to surrounding cities that are more likely to annex.

3. Limiting ETJs to home counties
   
   Limiting ETJs to a single county would effectively limit the ability of large cities to dictate regional growth.

Pros:
- Reduces control large cities have over expansive areas.
- Compels cities to offer services or release territory in a set timeframe.
- Could encourage annexation by smaller cities where residents oftentimes perceive annexation as more desirable and where SPAs are in heavy use.
- Reduction of ETJ and subsequent annexations by smaller cities could reduce the burden on county government.
Cons:

- Diminishes control for large cities.
- Reduction of ETJ powers would require careful transition of development standards review and inspections to either counties or other municipalities.
- Reducing the size of ETJs would not address persistent issues with low-resourced, low property value communities being left out of the mix. Even with greater opportunities for annexation, few cities would want to annex these areas or provide services to them.
- Currently, the City of Houston helps manage the mobility planning that occurs within its ETJ; considerably altering the boundaries would require other jurisdictions to step into that role.

B. Reform municipal planning commissions to joint city/county bodies

Using the City of Houston Planning Commission as an example, this body currently approves all plats and development within Houston’s ETJ. Per state law, counties within the city’s ETJ each have one seat on the commission. The rest of the commission is appointed and approved by the City of Houston. Effectively, the Houston Planning Commission controls approvals for all development in unincorporated Harris County with very little input from the county itself. (The same is true in Houston ETJ areas in four other counties as well.)

Several options exist to change this dynamic between cities and counties and to give additional say over development in unincorporated territories to counties.

- Existing planning commission rules could be shifted to give counties equal seats on current commissions. Such a move could give county officials direct say over development outside of cities.
- Bylaws of the existing planning commission could be changed to give city and county representatives approval of development within their boundaries.
- Counties can also create planning commissions, but without amendments to existing rules to empower a county commission, a city planning commission would remain the primary decisionmaker.71

Pros:

- Allows counties to have greater oversight and input into development within territories where they are a primary service provider.

Cons:

- Diminishes control for large cities. Requires a willingness from these cities to give up control.
- Would likely be tied to politically difficult decisions around ETJ powers.

C. Leverage SPAs for targeted annexations

Existing state legislation makes future annexations increasingly more difficult. Existing and future SPAs between cities and MUDs present an opportunity for planned annexations because current legislation allows for full annexation through an SPA without a vote. SPAs give residents ample time and opportunity to understand the annexation process. SPAs also provide MUDs and cities with a road map for planned growth.

Cities should evaluate their existing SPAs to identify MUDs that make sense to move toward full annexation and then should use the SPA process to plan that annexation in a way that works for all entities involved.

Pros:

- County burden for public amenities is limited to a window of time before a city needs to take over responsibilities in MUDs or the MUD incorporates.
- Former MUDs can take advantage of incorporated municipality funding revenue instead of relying solely on property taxes or the county government for maintenance.

Cons:

- Forcing MUDs to annex or incorporate could be politically difficult.
- Runs the risk of messy transitions if not done in concert with larger reforms so multiple options are on the table for MUD residents.
- Potential issues with service level declines for MUDs joining with cities.
- Lifespan approach could lead to slowdowns of development and a lack of entities in place to absorb huge debts.
- Could create a permanent patchwork of small municipalities that complicate regional governance.
D. Incorporation or creation of Townships

Select incorporations could remove service burdens from counties and replace MUDs with cities that have the full range of municipal powers and services.

The incorporation of new municipalities would require sign off from Houston within its ETJ or the reform of that system. Incorporation also must meet the eligibility rules for population and land area. Residents within the proposed city must also approve through a vote or petition.

Challenges to incorporation would be the fact that residents may not want to pay likely higher municipal taxes or take on longer-term costs such as pensions that come with municipal government.

A slightly different approach would be to use the township model pioneered by The Woodlands (see case study) to get some of the benefits of incorporation without the creation of a full municipality.

Case Study: The Woodlands Township

The Woodlands Township is the government entity that oversees much of the day-to-day governance of The Woodlands, Texas. It is a combination of several community associations (effectively HOAs) under the umbrella of a central improvement district. The community associations were created when The Woodlands was founded and the improvement district was created in 1993.

In 2007, Woodlands voters approved merging all of these entities into one and created the township form of government, which is effectively a municipality with more limited powers. The township has the power of taxation (both property and sales) and supports the community’s fire department, deed restrictions, parks and recreation system and neighborhood services. The township operations are considered essential governmental functions, but the township does not have the full powers of a municipality and does not have ordinance-making power.

The Woodlands Township is not a MUD, but works closely with the area’s master MUD, the Woodland Joint Powers agency, which coordinates the area’s 10 MUDs.

Individual MUDs, if large enough, or a collection of MUDs could choose to incorporate or create a township. This would likely be most feasible in contiguous MUDs that have standing partnerships and shared facilities. Incorporations and the township model would allow these MUDs to collect sales tax and other fees to provide a more robust level of public services and amenities.

Any incorporation would need to happen among entities generating enough revenue to make supporting a municipal government financially viable.

Pros:
- Reduces burden on county government.
- Reduces the number of jurisdictions and service providers in the region.
- Can build on existing close ties between contiguous MUDs.
- Incorporation allows for an increased number of public services.
- Allows for local control of development and growth.
- Ability for new municipalities to pass and enforce local ordinances.

Cons:
- Creation of additional municipalities could make regional governance more difficult by increasing fragmentation and reducing regional operations.
- Residents may object to incorporation and the associated costs that come with operating a full city—police, fire and public pensions among them.
- Houston and other cities may resist reforming ETJ rules or allowing incorporations.
- Townships do not address all service needs.

1-4. General Reforms

A. Compel HOAs to establish reserve funds

In most communities with HOAs, the entities are responsible for maintaining some common infrastructure and amenities, as well as enforcing covenants. Though the costs for emergency repair or action on infrastructure such as surface drainage systems, pools or privately-owned roads can be high, HOAs are not required to keep a reserve fund on hand for such contingencies. If and when those systems fail, MUDs, the county and the city can get pulled into helping the HOA address the issue.

Requiring HOAs to set a reserve fund for unexpected expenses would not only better prepare the communities...
to address issues, but also reduce the likelihood that other entities would need to get involved to address issues.

Pros:
- Long-term maintenance is not pushed to MUDs, the county or city government.
- Increases accountability for HOAs to maintain systems and amenities they are responsible for.

Cons:
- The requirement of a reserve fund could be a burden for HOAs in lower-income areas.
- Would likely require a higher HOA fee structure to maintain normal operations and to create a reserve.
- Resident opposition would be likely because of the requirement to raise HOA fees.

B. Board training and education

Much of the regional attention to the role of MUDs within the regional governance structure focuses on issues of public information and accountability. Options that build on the existing efforts of the Texas Legislature to provide public information, such as the Special Purpose Public Information Database, could help address transparency issues.

Expanding existing training and requirements for HOA and MUD leadership could also help strengthen the management of the current local governance system.75

The Association of Water Board Directors already offers an effective training system to help train and educate existing resident directors of MUDs. Ensuring this training is open to all residents, including those who may want to take a leadership role in the future, and creating a system for residents to learn more about how to manage districts could help structure effective governance over the long-term. HOA board training may need to be pursued by other regional bodies.

Pros:
- Expands existing programs to establish shared training and knowledge for residents about how to shape their MUD or district.
- Helps ensure greater financial stability for MUDs or HOAs.

Cons:
- Requires greater participation from individual residents, which is typically low.

2. Increased Collaborations

2-1. City, County and MUD Collaborations

A. City-County Collaboration

Cities and their home counties collaborate in innumerable ways. The entities share a number of service challenges and often work together to address them. Current challenges with providing adequate and equitable services to all residents could be aided by further collaboration.

Using Harris County and the City of Houston as an example, the two entities could work to ensure that infrastructure maintenance and service provision programs are being supported equally throughout both jurisdictions. Such a move should recognize that city taxpayers are contributing to the county budget without receiving equal infrastructure investment and seek to support both entities through joint projects.

The entities could build on existing collaborative infrastructure spending as is being done mainly through Commissioner Rodney Ellis’ commitment to help improve roadways for all road users near the University of Houston.

Similarly, the City of Houston can continue to help secure funding for major projects, as was done when it received a loan from the Texas Water Development Board in order to help the Harris County Flood Control District speed up the completion of a major piece of the Brays Bayou improvements.76

Pros:
- County and city collaboration could help address service and infrastructure problems in under-resourced or low-income communities.
- County spending within municipal limits on a more equitable scale could help address spending shortfalls and maintenance issues there.
- Collaboration could open up new funding mechanisms and money to leverage additional funds.

Cons:
- Sharing of revenue is politically contentious.

B. County-MUD Collaborations

MUDs and counties work closely together in providing services within districts. In most cases, counties are responsible for maintaining roads and pertinent storm sewers. Counties also collaborate with MUDs on up sizing infrastructure systems. This usually takes the form of a
While the City of Houston’s main interaction with MUDs is through its LPAs and other cities have engaged in a variety of ways to help improve services, either by signing MOUs or forming joint ventures, the City’s partnerships with MUDs could be strengthened. The City and MUDs have collaborated on mutually beneficial projects or services.

Pros:
- Collaboration could help each entity free resources for other projects and address needs within a district.
- Collaboration and service provision could help smooth the way to eventual annexation.

Cons:
- Issues with annexation and concerns about the level of service could complicate collaborations.
- Cities may be hesitant to provide services in areas not fully under their control.

C. City-MUD collaboration

While the City of Houston’s main interaction with MUDs is through its LPAs and other cities have engaged in a variety of ways to help improve services, either by signing MOUs or forming joint ventures, the City’s partnerships with MUDs could be strengthened. The City and MUDs have collaborated on mutually beneficial projects or services.

Pros:
- Collaboration could help each entity free resources for other projects and address needs within a district.
- Collaboration and service provision could help smooth the way to eventual annexation.

Cons:
- Issues with annexation and concerns about the level of service could complicate collaborations.
- Cities may be hesitant to provide services in areas not fully under their control.
- Most collaborations would not introduce a source of additional revenue, meaning limits of service provision for the county may persist.

D. Establish regional infrastructure evaluation

While design standards and construction standards are established at the outset of a MUD, ongoing maintenance and operations evaluation is much less standardized. Creating a regional program to ensure that all jurisdictions are functioning as they should could help address this issue. This could be a joint project of MUDs, counties, and cities.

Pros:
- Regional standards and inspections could be implemented at every jurisdiction.
- Shared information about the status of various infrastructure systems and the ability to prepare for long-term costs.

Cons:
- If not adopted by all jurisdictions, could lead to persistent inconsistencies.
- Could be perceived as a bureaucratic layer for those entities already evaluating infrastructure.
2-2. MUD to MUD Collaborations

Collaborations between MUDs exist on an ad hoc basis via contracts and interlocal agreements to share facilities or other costs, unless there is a master MUD model in place. Essentially, the master MUD acts as a coordinating body for a group of MUDs and usually manages major systems such as water treatment and provision. The master MUD provides services to the sub-MUDs, which pay a portion of their assessments to support the facilities and services provided by the master MUD.

In most cases, the master MUD model is used as a way to ensure that essential services and facilities are given enough financial support over time to continue operating. The master MUD model insulates major systems from declining tax rates or shifting resident priorities. The approach is used often in master-planned communities, but there are many areas within the Houston ETJ where MUDs operate as solely independent entities.

While the master MUD arrangement creates useful collaboration, it is usually only pursued in master-planned communities. However, similar models could be pursued by creating master MUD-like arrangements over the top of existing MUDs to better coordinate governance and service provision, or by systematically introducing more roles for collaboration between MUDs.

A. Encourage use of master MUD model

A promising opportunity would be to introduce a de facto consolidation of special districts by using the master MUD model over the top of existing, previously disconnected MUDs. Existing, likely contiguous, MUDs could agree to create a master MUD to provide essential services. A master MUD could operate the water plant for several MUDs, for example, without taking many other responsibilities.

There are several examples of master MUDs in the Houston region. The Woodlands Joint Powers agency, for example, is the central management agency for 10 area MUDs. It collects fees to maintain the main water system, but still allows the MUDs to manage other elements. Many master-planned communities have turned to the master MUD model as a way to ensure that major infrastructure systems are supported over the long-term. In most cases, these master MUDs are created early on in the process of development.
While technically feasible, creating a master MUD between existing MUDs with different tax rates or vastly different financial and infrastructural situations would be difficult.

Pros:
- Encourages coordination among MUDs.
- Collective funding through master MUD could help defray costs for major infrastructure systems and upkeep.
- Encourages inter-MUD collaboration and shared services, reducing the number of entities providing discrete services.
- Keeps the perception of “small government.”

Cons:
- Master MUD creation would require the approval of residents, which could be politically difficult.
- Master MUD model would likely raise tax rates for MUD residents.
- Master MUD model only be likely to work between MUDs that are contiguous and that share a relatively consistent financial and infrastructural status.
- Would require a lead actor to push for creation.

B. MUD-to-MUD Annexation

Another form of consolidation between MUDs would be for existing MUDs to annex other existing, neighboring MUDs. Under the water code, MUDs can annex additional territory with the explicit consent of a city, if the land falls within the extraterritorial jurisdiction of the city. However, in the case of consolidating and dissolving districts, the water code allows the board of individual districts to agree on terms of consolidation, including the assumption of responsibilities over bonds, notes and other obligations. After the consolidation, the districts effectively become a single district and debt and responsibilities are handled by the terms set in the initial terms for consolidation. In situations where neither an incorporation nor master MUD model is suitable, one MUD annexing another could be beneficial.

Such a move would allow for the costs of infrastructure maintenance and development to be collapsed into a single entity. It would also expand the tax base of the annexing entity to provide additional services.

As with the master MUD model, one major challenge is that annexation would likely only happen between MUDs of equal financial footing. It would be unlikely that an extremely well-established and solvent MUD would want to absorb a neighboring MUD that had outdated infrastructure or a low tax-rate. Residents of the more stable MUD would likely resist subsidizing the lower-performing entity.

Pros:
- Could help less stable MUDs improve their standing.
- Encourage inter-MUD collaboration and shared services, reducing the number of entities providing discrete services.

Cons:
- Does not address larger regional issues, by maintaining a fragmented network of local governance.
- Stable MUDs with tax rates that match need are unlikely to willingly absorb less stable MUDs.
The current system of service provision in the Houston region has been vital to its continued growth and expansion. Municipal utility districts, in particular, have played a critical role in facilitating this growth, especially after the City of Houston’s annexation system broke down.

However, as the current system has aged, a large number of vulnerabilities, including a patchwork service delivery pattern and an inability among local jurisdictions, particularly counties and cities, to pay for adequate urban-level services for all residents has emerged.

The current system could continue for some time without change, although the deficiencies in the system are likely to become more accentuated during that time. Harris County will have a more difficult time with road maintenance in particular, older MUDs will face the financial reality of replacing aging infrastructure and unincorporated areas outside MUDs will still struggle to obtain the services they need. These issues were not created by a single entity or decision, rather they have come to fruition as the result of decades of decisions by government and private-sector actors in the region, as well as by the choices of residents. Fixing the issues will likewise require a combined effort and will take time.

The experience of Hurricane Harvey highlights the fact that infrastructure and service provision issues are regional in nature, not local. In short, when it comes to infrastructure and service provision, we are all in it together. The current system, with its dependence on MUDs covering small geographical areas, has helped facilitate additional growth in the past few decades. Reforms to the system, however, will ensure long-term stability so that all residents of the Houston region, not just those inside cities and MUDs, are able to benefit from high-quality infrastructure and government services.
1 Mike Morris, “Feds, state sue Houston over years of illegal sewage spills,” Houston Chronicle, September 21, 2018.

2 The current FY2018 budget for roads and bridges is $417 million (Harris County 2018 CAFR), the $2.5 billion assumes a similar rate over six years.

3 Figures for projects within the City of Houston by the Harris County Engineering Department as of October 2018.


5 See testimony of Josh Stuckey to the Texas House Committee on Special Purpose Districts on November 30, 2017.

6 Texas MUDs are unique among these types of districts because of their very high bond ratings and well-established oversight regulation. For discussion of other types of special districts in Florida, where there are more than 1,000 community development districts, see Carol S. Weisert, “Hidden in Plain Sight: Florida’s Special Districts,” Leroy Collins Institute, Florida State University, 2014. For discussion of districts in California, where there are several dozen district types, including Water Districts, County Service Districts and Community Service Districts, see, California Special District Association, “Special District Formation Guide,” 2016; California Senate Local Government Committee, “WHAT’S SO SPECIAL ABOUT SPECIAL DISTRICTS? A Citizen’s Guide to Special Districts in California Fourth Edition,” 2010. https://www.ca-ilg.org/sites/main/files/file-attachments/resources_2010WSSASD4edition.pdf. California also has Mello-Roos districts, which are a tool used by local governments, including special districts, to finance improvements.

7 Kinder Institute for Urban Research, Collaboration and Overlapping Services in Harris County Law Enforcement, September 2018.


9 Solid waste, Texas Water Code § 54.203; Contracts, § 49.067 and 54.235

10 Texas Water Code, § 54.234.

11 Texas Constitution, Art. 16, Sec.59.


15 Mike Snyder, “Houston’s vast jurisdiction leaves many residents in limbo,” Houston Chronicle, June 16, 2016


17 Homeowner, Property Owner, and Condominium Owner Associations are governed by Texas Property Code, sections 201, 202, and 209 are particularly important.

18 Community Associations Institute, Summary of State Reserve Fund Laws (September 2013).

19 Underlying data about MUDs comes from TischlerBise analysis of Municipal Informations Services special district data. See supporting document from TischlerBise on the Kinder Institute’s website.

20 TischlerBise analysis of Texas Comptroller, 2016 Special Districts Rates and Levies for 2015.


23 Texas Constitution, Art. 16, Sec. 59, 2003


25 Texas Water Code, § 54.504

26 Texas Water Code, § 54.016.

27 In the 85th Session of the Texas Legislature, 56 pieces of passed legislation dealt with the direct creation of a new MUD or provided bonding or assessment authority. Dozens of other such pieces of legislation were filed. For an example piece of legislation see H.B. No. 1440, 85 (R).

28 This number differs from those in Figure 4 above because the financial records used in this report are from tax year 2015, the last complete year of data accessible.

29 MUDs were created with the addition of Chapter 54 to the Texas Water Code.


33 Ibid.

34 TischlerBise analysis of 2015 tax year MUD data.


Standard and Poors, “Lessons Learned from the 1980s Allow Texas Municipal Utility Districts to Maintain Stable Credit.” RatingsDirect on the Global Credit Portal; Ron Welch, “Revival of Houston Area Municipal Utility Districts,” Institute for Regional Forecasting, November 2001

Chapters 16 and 20 of the Texas Water Code were both substantially amended in the 1987 and 1989 legislative sessions. These amendments added a number of financial solvency checks. Similarly, the Texas Administrative Code was updated to direct the TCEQ’s oversight of MUDs and add financial checks to the system.

Texas Admin. Code. Title 30, Sec. 293, Subchapter E, Rule 293.54

Texas Admin. Code. Title 30, Sec. 293, Subchapter E, Rule 293.47.

Texas Admin. Code. Title 30, Sec. 293, Subchapter E, Rule 293.59

Ibid.


Senate Bill 89, 76 (R), 1999.

Shelby County v. Holder, struck down the preclearance requirement of the Voting Rights Act.


Texas Local Government Code § 43.0751.

Texas Local Government Code, §212.172.

Texas Local Government Code, § 212.171.


For details on Sugar Land's approach see the SPA between the city of Sugar Land and New Territory, signed November 5, 2007.

This type of agreement is laid out in Texas Local Government Code § 43.0751.

And example SPA agreement between the City of Houston and the Trail of the Lakes MUD, is available at http://trailofthelakesmud.com/wp-content/uploads/2014/08/Proposed-Strategic-Partnership-Agreement-SPA-00216893xAB154.pdf

City of Houston Limited Purpose Annexation Records.

Texas Local Government Code §42.044, 43.136

http://www.houstontx.gov/ecomdev/industrial_districts.html

Texas Water Code §49.057

Right to contract. Tex. Water Code Ann. § 49.067

For additional restrictions see Texas Water Code § 49.052


Texas Legislature, SB 625 85 (R), https://spbtpid.comptroller.texas.gov/
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