

## The Skinny on Castle Hills Annexation

JANUARY 6, 2012 BY JOHN EHINGER AND PATRICK KELLY

Annexation into Lewisville is a submarine issue in city and water district politics. Periodically it surfaces with a big splash, only to dive again for a while and resurface later. Like many homebuyers in Castle Hills, you might have been told that annexation into Lewisville was imminent –likely within a few years. In reality, there is no definite plan for when, or even if, Lewisville will annex Castle Hills. The City of Lewisville has indicated that it will only annex Castle Hills when doing so will not result in a financial burden to current Lewisville taxpayers.

It's not clear what scenarios would not create a "financial burden." A city must generally charge a uniform tax rate in all of its territory. When a city annexes a water district, it assumes its bond debt. Thus, annexing a district with a higher debt level could result in higher taxes for the current citizens. Lewisville Councilman John Gorena states a common concern; "According to data I've been given, [annexation] would result in a property tax increase between 20 and 40 cents to all Lewisville property owners." Ulf Andersson, a director of DCFWSD 1-D, adds, "If they annexed [Castle Hills] today there would be a great extra burden on the Lewisville residents that no Lewisville politician in their right mind would support."

Basically, the City of Lewisville must expect a financial gain, or at least no net loss, from annexing Castle Hills. As Lewisville Councilman TJ Gilmore puts it, "Cities annex to generate additional revenues, whether those come from water and sewer, emergency medical services, sales tax collection, property taxes, or fees."

But when could Lewisville annex Castle Hills without increasing taxes? The primary variable that will answer this question is the ratio of Castle Hills assessed value to its total debt. As of 2011, Castle Hills had a taxable value of around \$1.3 billion with debt of around \$95 million. By comparison, Lewisville reports assessable value of approximately \$7.3 billion and total tax supported debt of about \$105 million. This gives Castle Hills a value to debt ratio of 14 as compared to 70 for Lewisville. How these ratios change over time will likely decide when Castle Hills is annexed.

With typical Castle Hills district bond issuance having a final maturity of 30 years, even if development stopped and the districts issued no more debt, it is unlikely annexation would be attractive for many years. As DCFWSD 1-B director Guy Harris explains, "Most of our debt matures between 2025 and 2035, and annexation may start to make financial sense in the years before the debt is fully paid down, depending on what happens with the value of homes in Castle Hills. However, it seems very likely that the developer will continue to add debt, thereby pushing the likely date of annexation out further."

Indeed, by all indications, development will continue and more debt will likely be issued by DCFWSDs 1-G and 1-H. Generally, new development adds assessable value, making annexation more attractive, but new debt hinders it. As noted in our December article, future development will likely consist of office, retail, multifamily and restaurant space. Such development, while adding overall debt, may actually make annexation attractive sooner. This is because new value along with sales tax revenue might lead to a better ratio of value to debt than existing districts. Moreover, a significant portion of the future bond debt may consist of Public Improvement District (PID) debt for improvements that water districts cannot fund – like parking. Unlike water district debt which is paid by property taxes, PID-only debt would

remain the responsibility of the property owners, and would not become an obligation for Lewisville payable with property taxes.

Other factors will likely play a material role in determining when Castle Hills can be annexed. For one, annexation will have basic transaction costs – legal expenses, underwriting expenses, as well as logistical burden, and consumed staff time. Another issue is that the City of Lewisville may assume the Castle Hills’ districts’ obligations to the Upper Trinity Regional Water District. Yet another factor is the synergy achievable by transitioning to city services – the extent to which the City can provide services at lower cost. The assets and financial situations of the individual districts would also likely affect the City’s decisions. Cash and reserve balances and useful equipment provide additional incentives to annex whereas deferred maintenance and other liabilities have the opposite effect. Further, residential home value appreciation rates in Castle Hills and the City, the City’s future tax rate, and external events such as changes to federal or state sales tax policies, could all play into the annexation calculation.

Aside from financial considerations, there may be political and cultural factors at play. One concern is that post-annexation Castle Hills’ residents will simply take over Lewisville politics. Councilman TJ Gilmore frames the concerns echoed by others; “Lewisville might explore single member or mixed member council elections as Castle Hills could potentially field better funded candidates with a real competitive advantage...HOA lists.” Moreover, Castle Hills and Lewisville are perceived to have significantly different demographics. Whereas Lewisville has a long standing tradition of localism and families with generations of history in the area, 15-year old Castle Hills does not. Further, Castle Hills’ residents typically find it more convenient to shop, enroll kids for sports, etc. in other cities such as Carrollton. In addition, a survey of residents in 2009 reveals Castle Hills has an average annual household income of over \$190,000. As a comparison, the Lewisville Economic Development website notes that only about 8 percent of Lewisville households have an average income of over \$150,000. Whether these differences represent a true and lasting cultural gap between Castle Hills and the City of Lewisville, and whether they will play a role in future annexation decisions, remains to be seen.

Annexation may bring several benefits for Castle Hills’ residents. First, it would create an arguably more representative, or at least a more familiar, government structure. Second, it would allow Castle Hills’ residents, property owners, and utility customers to benefit from the City’s greater economies of scale. Third, it would make available to Castle Hills a broader set of services – transportation, libraries, senior centers, recreation centers, and animal control – which cannot be provided by water districts. Fourth, it would result in the imposition of broader regulatory authority than is possible in water districts such as nuisance and zoning ordinances. In addition, it would bring Castle Hills into the relatively greater legal certainty and political safety of a home rule municipality. However, annexation might also bring uncertainties. Will the City maintain the same or better level of services as the districts – such as park and median maintenance? Are some amenities and additional regulatory authority viewed as undesirable by Castle Hills’ residents?

While the expectation is that all of Castle Hills will be annexed together, it may be possible for the City to annex more mature residential districts earlier. However, even the most mature districts have a value to debt ratio that is a fraction of Lewisville’s. Annexing parts of Castle Hills would also require reworking existing contracts and financial arrangements and would require a grand coalition consisting of the City, the water district boards, the developer, and others – a coalition which has proven elusive to date.

The final chapter of the future of Castle Hills has yet to be written. Although annexation is the most probable outcome, other options may be available, such as incorporation as a municipality. The future of Castle Hills, if and when the City of Lewisville may annex us, and other questions will likely be an ongoing discussion. Each year as the fortunes of the City, the districts, and the developer change, the prospects and timing of annexation or other options will change as well.