

The Most Powerful 1.726 Acres in Castle Hills

OCTOBER 11, 2011 BY JOHN EHINGER AND PATRICK KELLY

Our last article gave an overview of how Castle Hills is governed through eight Water Control Improvement Districts labeled 1A through 1H, each governed by a board of 5 directors. If you live in Districts 1B, 1D, or 1E, you are represented in majority by other residents. If you live in 1F, 1G, or 1H, your representation was effectively appointed by the developer. If you are living, in 1C we need to chat – that’s the golf course.

If you noticed that 1A is not in the list above, congratulations! You’ve been paying attention. 1A is a district that is tasked with the management of all Castle Hills districts. Consisting of just under 1.75 acres and no homes, it has been parceled out to allow 1A directors to sit on its board. So how did this come to be? In this column, we dig a little deeper into the roles of 1A versus the other districts, the roles of the staff and other professionals, and provide opposing views in summary.

Creation of districts and how directors are chosen

To serve on a board, a person must own property “subject to taxation” in the district. They don’t actually have to pay the taxes, just own taxable property. To accomplish this, a developer typically deeds lots to the original board candidates. The developer also leases or provides, for free, some form of dwelling – like a trailer – to the initial “residents” of the districts. The developer and the “residents” then petition for an election to create a new district, define its powers, and authorize bonds. Predictably, the election prevails. The “residents” move away, leaving behind a district with a board of nominal property owners but no residents. When a vacancy arises, the remaining board members elect a replacement. While district boards are subject to re-election every four years, if a district doesn’t have any resident voters, then the property owners – the initial board and the developer – effectively control who can serve on the board. When a district is developed and resident homeowners move in, they can run for election to their district board and can vote in those elections. The Dallas Morning News wrote a series of articles in 2001 entitled ‘Government by Developer’ that focused on how this process was used to create the Castle Hills districts as well as those for Lantana, Savannah, Providence Village, and others. At least one of these articles is still available online and can be found via a quick Google search on the phrase ‘Government by Developer.’ For anyone with even a passing interest in water districts, it’s required reading.

How other districts are created

Developers of large special developments commonly use multiple districts, largely to have a smaller ratio of bond debt to taxable value which makes the bonds marketable. If you were a bond investor, would you buy a bond from an entity with \$10 million in taxable value that had the authority to issue \$100 million in bonds and no real plans for developing most of its territory? We hope you said “No.” To create multiple districts, developers and “residents” go through a process of spinning off new districts similar to the initial creation – land deeded to initial director candidates, a handful of residents with free or low cost rent, an election, and no residents until development.

Creation and division of Castle Hills’ districts

The first district created was called “DCFWSO 1” which the Bright family created on their land. The Dallas Morning News notes that this was done in part as a defensive measure to avoid annexation, taxation, and regulation by nearby cities. When development commenced, the territory of DCFWSO 1 was split into DCFWSO 1A and DCFWSO 1B. DCFWSO 1B then commenced being developed and issued bonds. Because the developer as the land owner generally can control who the property owners are, the developer was effectively able to appoint the initial board of DCFWSO 1B. Director lots are usually tucked away in obscure places within each district – such as under Lake Avalon.

Role of the City of Lewisville

One unique feature of Castle Hills’ districts’ government is the role of the City of Lewisville. As part of an overall strategy of the city and the developer to develop Castle Hills and to provide sewer, water, roads, police, fire, and EMS services (see last article), the districts issue bonds pursuant to a contract with Lewisville called a Joint Utility Contract. This enables the districts to leverage the credit worthiness of the city but also puts the city’s credit rating at some risk if a district is mismanaged and defaults. To address this risk, the Joint Utility Contract obligates the districts to maintain its various municipal systems and to enter into an Operating Agreement with DCFWSO 1A. The bonds typically have maturities around 30 years. The Joint Utility Contract has a period of around 30 years, and the Operating Agreement has a period of 40 years. Each new district typically enters into these contracts as soon as they are created – meaning that the initial board of nominal property owners which were elected by nominal residents basically commits each district to this structure well before any resident homeowners move in.

These mechanisms combine in such a way that every new district incurred significant bond obligations and ceded some degree of control to 1A. 1A retreated in territory but its board remains effectively appointed by 1A’s sole land owner, which is the developer. The result is that residents can get elected to the non-1A boards, but their board has only limited direct control over the policies that affect their residents. Residents do not have the right to elect representatives to the 1A board because no one lives there.

What are the roles of 1A versus the other districts?

Under the Operating Agreement, 1A must propose an annual budget for each of the districts. If the actual expenditures for the prior year and the current year are within 12% of the respective budgets (excluding costs incurred directly by the district and costs resulting from customer usage), 1A has the authority to set the budget for the other district. If it is within these rails, 1A’s budget is imposed on the districts and the comments of the other districts’ boards are advisory only. The individual boards retain control over professional services (lawyers, accountants, consultants) and retain control over their tax rates and exemptions as well as their utility rates. Costs spent directly by the individual boards are allocated to that board. Costs incurred by the entire system are allocated on the basis of one of several methods, generally by relative property values or by its ratio of water connections. The boards for districts 1B-1H can be legally compelled to vote to set taxes and rates to meet the budget as proposed by 1A. The discretion of the other districts to lower taxes or utility and permit rates – the primary sources of revenue for each district – is in practice significantly limited by their obligation to meet 1A’s budget.

Who runs this place anyway? Directors do

Each board has five directors. 1A, 1C, 1G and 1H currently have no residents and no property owners other than developers and board members (Bright is not the only developer in CH). 1B, 1D and 1E have resident majorities. District 1F (Castle Hills North, Castle Hills West, and Target) has residents but has not had an election. Its board includes one Castle Hills' resident.

Who runs this place anyway? Professionals

1A and all of the other districts except 1B employ Ft. Worth law firm Kelly, Hart, and Hallman for legal counsel. 1B employs Shupe, Ventura, Lindelow & Olson, PLLC for its legal representation but shares the costs of "system-wide" legal expenses as allocated to it by 1A. All of the districts employ McCall, Gibson, Swedlund, Barfoot PLLC as auditors. The districts employ consultants for various purposes – sometimes individually and sometimes jointly with other districts.

Who runs this place anyway? Staff

1A is the operating district that employs all of the district employees, owns the equipment and buildings, leases office space, and generally maintains and operates the system. 1A's staff is headed up by a General Manager. Zane Miller, the former Economic Development Director for the City of Lewisville, has been General Manager since 2007. We hope you've stayed with us thus far. The authors' views diverge a bit on what is right and wrong with the system and what should be done going forward.

Opposing views

John Ehinger's View

Clearly, the structure does not provide residents with a means of direct control the way that a city council can. A common reaction of residents who first look into the structure is that it must be somehow illegal. Most press coverage of the districts encourages this view usually by noting selectively that the original purpose of the laws allowing for the creation of districts was to enable "poor" and "rural" communities to provide water and sewer. This view ignores almost a century of intervening modification by the legislature to make it easier for developers to utilize special districts to develop subdivisions. It also ignores the multiple layers of third party approvals (by the city, county, or Texas Commission on Environmental Quality, and by the Texas Attorney General) that are necessary in order for a district to be created and issue bonds. For a district and a structure that has passed all of these hurdles, as have the Castle Hills districts, it seems unrealistic to think that the whole system could be brought asunder because some fatal flaw has been overlooked all these years. The practical conclusion is that this structure is not just legal but is largely encouraged by existing laws to promote development.

A better and less disruptive (and much less expensive) way to improve the districts' government, rather than trying to challenge the legality of the structure, is to try to work within the system to bring the districts closer to something more like a normal municipal government. Doing this requires a receptive 1A board and staff, but it's in their best interest to cooperate with resident directors and other active residents because doing so lends credibility to the structure and because even though Castle Hills residents can't vote for the 1A board or in city council elections, they can vote for county offices, Lewisville Independent School District trustees and state legislators. It is also in the developer's and city's interest to ensure that Castle Hills' municipal system functions prudently, effectively, and efficiently.

I entered Castle Hills politics somewhat alarmed by the structure but also by the fact that there didn't seem to be many residents who understood who was in charge and how our tax dollars were being spent. In addition, the various entities in control historically seemed to resist resident involvement and lacked transparency. My two or so years of active involvement, however, have convinced me that the system is workable enough. After some initial resistance, 1A has responded by accommodating and addressing many of the key concerns of residents. And as I've learned more about the districts and municipal management, I have come to see that many policies I questioned, I now simply agree with. An example of this is the much maligned reserve policy under which 1A has been budgeting several hundred thousand dollars per year per district for cash reserves. At first seeming arbitrary and resulting from a reluctance to allow districts to lower tax rates, I have realized that reserves are a necessary part of any municipal system and that the failure to have a reserve is generally viewed as increasing credit risk, which results in higher interest rates leading to higher taxes. In fact, I'm now more alarmed that districts operated for as long as they did without reserves.

There are problematic aspects of the structure and things I wouldn't have supported – such as how the cost of the treated sewer water used to irrigate the golf course is allocated. But on these issues, 1A has demonstrated its willingness to help us manage out of them.

The result of my two or so years of involvement is that I have become generally supportive of the structure and of 1A's management, not because it's how I'd have drawn it up, but that doing so is simply the best path to protect residents' interests, primarily toward getting lower taxes.

Still, though, the structure is weird and is potentially undemocratic. Residents can and should stay more involved. That involvement needs to be based on an understanding of how the districts operate but involved residents should try to separate how the structure should be from how it is. Practical and reasonable activism by residents can help achieve a more efficient district, can lead to lower taxes and enhanced services, and can help facilitate full annexation sooner. The only way out is through.

Patrick Kelly's View

Let's think back to what we learned from Schoolhouse Rock. As detailed in 'Three Ring Government', we are a nation of checks and balances. As sung in another favorite, 'No More Kings', we are a nation of representative government. How big of an uproar would there be if congress signed 40 year contracts with GE effectively delegating authority to their board of directors? This is the same concept, just on a smaller scale.

In a perfect world where everything gets done on a handshake, and everyone has a perfect understanding of what everyone else is trying to accomplish, perhaps there is no harm. However, in a world where disagreements arise between residents and the developers, certainly a board that is independent of personal relationships is in order. Let's bring this to a real life example. As mentioned, it is possible for a board to retain their own legal counsel – but only for direct services provided to the board. The aforementioned 40 year operation agreement states clearly that 1A is the only party authorized to represent the districts like 1B for things like contracting with other parties, unfair in my opinion.

With this in mind, district 1B is currently involved in a lawsuit with the developer regarding reimbursement of certain expenses. District 1A counsel resigned as 1B representation, stemming from a

disagreement a couple of years ago. As such, the door was opened for 1B to retain its own independent counsel, which it did. In my opinion, 1B now has fair, uninfluenced legal representation. As we mentioned, the 1A board recommends the tax and utility rates needed to cover their budget. Recall all the other boards are advisory only to 1A (with the 12% exception of course). As 1A has no obligation to listen to the other boards regarding the budget, the result is the other boards must set tax and water rates to meet the budget dictated by 1A. The inevitable result is of course, the other boards have very little latitude in setting their own rates and 1A drives the train from the rear. He who sets the budget sets the rates.

In the 2010 elections, residents succeeded in winning all nine seats held by non-residents. Since the election, we have seen a much more open and engaging 1A board. While we cannot have representation on 1A, resident controlled boards allow for more checks and balances that we enjoy in all other aspects of American politics. We have elections coming up in May 2012, and there is ample opportunity to run for open seats on your board. Those who lack interest in running for office may simply attend the meetings of their board. The best thing you can do is to get informed and involved. - See more at: <http://allenpub.com/the-most-powerful-1-726-acres-in-castle-hills/#sthash.crYVXMHb.dpuf>