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Texas cities weigh PIDs as alternative to MUD bonds

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DALLAS — Texas cities and counties seeking more control over their fiscal futures are finding alternatives to the municipal utility districts that have blanketed suburbs across the state.

Public improvement districts, which account for just a fraction of the state's special district bond issuance compared to MUDs, allow fast-growing suburban cities to maintain their governmental authority and the benefits of a growing tax base while financing new housing, experts say.
One advantage PIDs hold for local government is control.

“Unlike MUDs, PIDs are a conservative city controlled tool which reduces future debt burdens to homeowners as well as facilitating quality development that meets or exceed city standards,” said R.R. “Tripp” Davenport III, director of investment banking at FMS Bonds. “Plus PIDs eliminate the need for the formation of uncontrollable governmental bodies within the city’s jurisdiction.”

MUDs are regulated by the state, require a local election to issue bonds, and exist separately and out of the control of a city or county government.

PIDs, in contrast, are created by a city or county. Debt service on MUD bonds come from property taxes, whereas PID debt service comes from an initial assessment that does not change over time. While a bond issue from an individual MUD requires its own finance team, PID bonds rely on the local government’s existing finance team. Although PID bonds are issued by cities or counties, they are special assessment revenue bonds backed only by assessments and not by the local government's general obligations. They carry separate ratings from the government's credit.

“The truth is there’s some animosity in the state between the PID group and the MUD group,” Julie Peak, managing director of Masterson Advisors, told The Bond Buyer’s Texas Public Finance Conference Tuesday.

From a developer’s perspective, PIDs are attractive because they can supply money up front. MUDs can't, according to Peak, one of the top financial advisors to MUDs in the Houston area. “That’s a very important incentive that we can't provide.”

Jason Hughes, managing director for Hilltop Securities, told the conference that he says PIDs created beyond the extra-territorial jurisdiction of a city make little sense. The point of PIDs, he said, is to keep the property on the city's tax rolls.

"PIDs can provide for public safety, water, sewer, streets, parks, libraries and other needs," he said. "I know of one case where PID bonds were used for a parking garage."

Since the Dallas-Fort Worth suburb of Trophy Club created the first municipally bonded PID in Texas in 2007, dozens of cities large and small have followed the template.

Since 2014, the Austin suburb of Leander, one of the fastest growing cities in Texas, has approved three PIDs since 2014 known as Oak Creek, Deerbrooke and Crystal Springs.

The city has sought to avert the fate of Dripping Springs south of Austin, which is surrounded by MUDs over which it has no control and cannot tax.

While Texas has about $3 billion of MUD bonds outstanding, PID bonds as about “$300 million and growing,” Davenport said.

Yields on PID bonds are generally about 100 basis points higher than on MUD bonds because they are perceived as riskier, Davenport said. While PID bonds are a “one-and-done” deal, MUDs can tailor bond issuance to growth in a subdivision.

MUD bonds are appropriate for individual retail investors, but PID bonds are marketed in $100,000 denominations to sophisticated institutional investors who have a higher risk tolerance and a need for higher yield, Davenport said.

For retail investors, state regulation of MUDs adds a degree of comfort for investors, said Peak, who noted that no Texas MUD has defaulted since legislation in the late 1980s that made the districts less speculative after widespread defaults.

Douglas Benton, vice president and senior municipal credit manager from Cavanal Hill, said that his investors, primarily high-wealth individuals, are receptive to MUD debt but shy away from PIDs.

“From an investor’s perspective, Texas MUDs benefit from the more stringent state oversight that was put into place during the late 1980s,” Benton told The Bond Buyer. “One could infer that lack of oversight from a state agency was a factor in the defaults experienced in Florida Community Development Districts. These Florida CCDs are secured with special assessments, which appear similar in legal structure to the Texas PIDs.

“A second challenge for special assessment bonds is their payment pattern,” he added. “Since they are assessments on property that can be paid in full at one time, the flow of repayment funds can be erratic. This leads to investors being pre-paid (bond called) sooner than a comparable bullet maturity. That type of risk can also lead to a demand for a wider spread by investors.”

Even during the housing collapse of 2008 that damaged values elsewhere in the country, “we really sailed through fairly easily,” Peak said.

“MUDs represent a reliable, safe form of debt issuance,” she said. “I definitely think it’s one of the greatest public-private partnerships you see across the state.”

Backers of PIDs challenge the notion that MUDs face stricter regulation than PIDs. The PIDs are also closely regulated by cities instead of the state, and the cities must meet higher standards than the state, they say.

In 2018, the rate of MUD bond growth slowed, but that was primarily due to after-effects of Hurricane Harvey in the Houston area, according to Moody's Investors Service.

Of the 968 active MUDs statewide, 662 are in metropolitan Houston, according to the Federal Reserve Bank of Dallas.

“The high concentration of MUDs in the Houston area may expose this financing model to new risks — those associated with more frequent and catastrophic flooding events,” a 2018 report from the Dallas Fed said. “While MUDs will likely remain a vital part of the developer’s toolkit, this type of debt could become costlier and raise home prices in residential developments. And rising costs for homeownership might diminish one of the Houston area’s traditional selling points: affordability.”

The Texas Commission on Environmental Quality administers the creation of MUDs and other water districts, though not their day-to-day operation. Filing an application to establish a MUD costs $700 and can be completed within 120 days with approval by the state environmental commission. Otherwise, the Texas Legislature can authorize a district through the legislative process. Local MUD boards, often including developer and resident representatives, oversee management.

Although PIDs were first authorized by the Texas Legislature in 1987, attempts to issue bonds based on the statute were thwarted because it was so poorly written, Davenport recalls.

After the 2007 issue from Trophy Club, attorneys from the law firm of Vinson & Elkins, underwriters and other interested parties helped draft legislation in 2009 and 2011 that made the financing tool more accessible, Davenport said.

When the housing collapse came in 2008-09, home construction generally cooled off. But since then has been steadily picking up, he said.