Legal Q&A
Bill Longley, TML Legislative Counsel

Q. What is a municipal development district (MDD)?

A. An MDD is a political subdivision created by a city to plan, acquire, establish, develop, construct, or renovate one or more development projects beneficial to the district. TEX. LOC. GOV'T CODE §§ 377.021 and 377.022. An MDD closely resembles a Type B economic development corporation (EDC), with some key differences (discussed below). The MDD is funded through a dedicated local sales and use tax that must be approved by the voters in an election held within the district. *Id.* § 377.101.

The concept of an MDD was first introduced in a limited capacity in 1999, when the Texas Legislature authorized the City of Aransas Pass to create an MDD. In 2001, legislation passed to provide that any city located in multiple counties could hold an election to adopt an MDD. Finally, in 2005, the Texas Legislature amended Chapter 377 of the Local Government Code to enable any city to establish an MDD. According to the Texas Comptroller at the time of this writing, 40 cities have created MDDs. (Website of Texas Comptroller of Public Accounts, *Special Purpose District Sales and Use Tax*, https://comptroller.texas.gov/taxes/sales/spd.php.)

Q. What are the authorized rates of the MDD sales tax levy?

A. The rate of an MDD sales tax may be one-eighth, one-fourth, three-eighths, or one-half of one percent of the cost of goods sold within the MDD that are subject to sales taxes. *Id.* § 377.104. The combined rate of all local sales taxes within the district, however, may not exceed two percent. *Id.* § 377.101(c).

Q. What may an MDD sales tax be spent on?

A. An MDD sales tax is a dedicated city sales tax, meaning its proceeds can only be spent on certain authorized projects (as distinguished from a general purpose tax which can be spent on any lawful city purpose).

An MDD sales tax is an economic development tax that can be spent on authorized "development projects," which include any of the following:

(1) Any "project" as that word is defined by Sections 505.051 through 505.158 of the Local Government Code. *Id.* § 377.001(3)(A). In other words, the MDD tax automatically encompasses any project available to a similarly-sized Type B EDC.

(2) A convention center facility or related improvements such as a civic center or auditorium. *Id.* § 377.001(3)(B).

(3) Parking lots for such convention or related facilities. *Id.* § 377.001(3)(B).

(4) Civic center hotels. *Id.* § 377.001(3)(B). This authority can be quite important; funding of civic center hotels with other funds, such as hotel occupancy taxes, can be controversial both legally and politically.

Q. Can an MDD be created to encompass the city's extraterritorial jurisdiction (ETJ)?

A. Yes. When a city holds the election to create a district, the district may be created in: (1) all or part of the boundaries of the city; (2) all or part of the boundaries of the city and all or part of the boundaries of the city's ETJ; or (3) all or part of the city's ETJ. *Id.* § 377.002.

While the MDD statute authorizes the boundaries of the MDD to include the city's ETJ upon the creation of the district, it should be noted that there is no express statutory authority to later modify the boundaries of the ETJ. In other words, an MDD that is initially created to only include the city limits cannot later be expanded – by election or otherwise – to include the city's ETJ.

Q. If the MDD so closely resembles an EDC, why not just create a Type A or Type B EDC instead?

A. There are several distinctions between an MDD and an EDC sales tax that might make the MDD preferable to an EDC in a particular city:

(1) The scope of projects that can be funded with an MDD sales tax is slightly larger than that of a Type B EDC sales tax (see above).

(2) An MDD sales tax need not be levied over the entire corporate limits of a city, as an EDC sales tax must. This can be useful for cities that straddle county boundaries and are thus "maxed out" at their two-percent local sales tax cap in some areas of the city but not in others. The statute states that the city can create the district (and thus levy the tax) in "all or part of the boundaries of the municipality." *Id.* § 377.002(a)(1).

(3) As mentioned above, an MDD sales tax may be imposed in a city's ETJ if the voters of the entire district approve the tax. *Id.* § 377.002(a)(2). The MDD sales tax is the only city sales tax that may be levied in the ETJ of a city.

(4) The MDD statute does not have the same level of detailed restrictions that the EDC statute does. For example, the EDC statute prevents the city from giving aid to an EDC. *Id.* § 501.007(a). The MDD statute contains no such restriction. The MDD statute only references the Type B EDC law to define the permissible projects of an MDD; it does not incorporate the other procedural and substantive aspects of the EDC statutes.

(5) The board of an MDD consists of a minimum of four persons. *Id.* § 377.051(a). A Type B corporation has a seven-member board. *Id.* § 505.051. Many Type B EDC cities, particularly smaller cities, report difficulty in locating persons willing to serve on the Type B EDC board. The smaller MDD board can help in this regard.

Q. Can an MDD spend its revenue for authorized projects outside the district?

A. One area where MDDs clearly have less flexibility than an EDC relates to spending on projects located outside the boundaries of the district. An EDC may undertake projects outside of the city limits with permission of the governing body that has jurisdiction over the property. *See Id.* § 501.159. For instance, if a potential project is located completely within the jurisdiction of another city, the corporation would need approval of the city council of that city before funding the project.

An MDD, on the other hand, is only authorized to fund projects located within the boundaries of the district. As a general matter, an MDD may use money in the development project fund only to "pay the costs of planning, acquiring, establishing, developing, constructing, or renovating one or more development projects *in the district*" (Emphasis added.) *Id.* § 377.072(a). So if the boundaries of an MDD include the corporate boundaries of the city, the MDD is not clearly authorized to spend money on projects located in the ETJ.

Q. Is an MDD required to follow certain procedures when selling or conveying real property owned by the MDD?

A. Yes. Unlike an EDC, an MDD is considered to be a political subdivision of the state. *Id.* § 377.022. As such, an MDD must comply with laws that are generally applicable to political subdivisions. This includes Chapter 272 of the Local Government Code, which establishes a notice and bidding process for the sale of real property by a political subdivision.

Q. Is an MDD required to have bylaws?

A. No. Chapter 377 of the Local Government code is silent regarding the adoption of MDD bylaws. Because MDDs operate in a similar manner to EDCs, and state statute specifically provides for the creation of EDC bylaws, many cities also adopt MDD bylaws. Unlike EDCs, there is no specific procedure to follow to adopt or amend MDD bylaws.

Q. The ability of a Type B EDC to fund commercial and retail economic development projects depends on the size and/or Type B revenues of the city. Does this distinction extend to an MDD as well?

A. Likely so. The MDD statute, when listing eligible projects that can be funded by the MDD sales tax, incorporates by reference the section of the Type B laws that contains the population/revenue distinction with respect to commercial and retail projects. *Id.* § 377.001(3)(A).

Thus, a court would likely find that the ability of an MDD to engage in general commercial and retail economic development projects depends on the same population/revenue distinction that is contained in the Type B statute. Specifically, an MDD district with less than 20,000 population, or less than $50,000 in revenues from the MDD sales tax in each of the two preceding years, may fund commercial and retail economic development projects with the MDD sales tax. *Id.* §§ 505.156 and 505.158.

MDDs that don't meet either of those criteria would be limited to Type B projects other than commercial and retail. These MDDs could fund projects that are of a more "blue collar" variety (the statute uses the term "primary jobs"), such as industry and manufacturing, as well as certain targeted infrastructure projects, and recreational or community facilities, among other things. *Id.* §§ 501.101, 501.103 and 505.152. Such a district would still have the additional MDD projects available to it such as convention centers and civic center hotels.

Q. If a city wants to replace an EDC sales tax with an MDD sales tax, can it use a combined ballot proposition?

A. Section 321.409 of the Texas Tax Code authorizes a city to repeal or lower one city sales tax, and raise or adopt a different city sales tax, all with one combined ballot proposition. The fact that this can be accomplished by one combined ballot proposition protects the city's interest by eliminating the risk that one tax will be voted out by the citizens without the other tax being voted in. A combined ballot proposition must be worded to contain substantially the same language required by law for each of the two taxes individually. TEX. TAX CODE § 321.409(b).

Although a city is permitted to have a combined ballot proposition to switch from an EDC sales tax to a MDD sales tax, doing so could create a unique problem. If the boundaries of a proposed MDD are to include all or a portion of the city's ETJ, then the MDD would cover a different taxing area than would the EDC. As a result, the combined ballot proposition would either: (1) allow voters living outside the city limits in the ETJ to vote to terminate the EDC sales tax that was never imposed on them in the first place; or (2) would allow voters inside the city limits to impose the MDD sales tax in an area in which the actual residents living in that area did not have the opportunity to vote.

In at least one instance, the comptroller's office refused to honor the results of a combined ballot proposition to replace the EDC sales tax with the MDD sales tax because the city permitted voters in the ETJ to vote on the proposition that would (in part) abolish the EDC sales tax, even though that tax was never imposed in the ETJ. Because the comptroller has taken this position in the past, a city should consider using two separate ballot propositions if the boundaries of the MDD will differ at all from the boundaries of the EDC.

Q. May MDD sales taxes be pledged to pay off bonds?

A. Yes, MDD sales taxes may be pledged to pay off bonds, including revenue and refunding bonds, or other obligations to pay the costs of a legal MDD development project. TEX. LOC. GOV'T CODE § 377.073.