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MEMORANDUM

TO: Timothy L. Firestine
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Jennifer Barrett, Director
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VIA: Leon Rodriguez
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FROM: Marc P. Hansen
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DATE: September 7, 2007

RE: Financing Development District Infrastructure—Implementation

This memorandum addresses the processes the County must follow to construct, acquire, or finance infrastructure improvements to be funded by a development district created under Chapter 14, Development Districts.¹ More specifically, we answer the question of whether Section 14-16 requires that infrastructure improvements identified for funding by a Council resolution adopted under Section 14-9 must be acquired through a competitive procurement process under Chapter 11B, Contracts and Procurement.

ANSWER

The process the Executive Branch must follow to construct, acquire, or finance infrastructure improvements depends on various factors. If the Council resolution appropriating funds for infrastructure improvements expressly provides that the infrastructure must be acquired through a specific developer, the Executive Branch generally must enter into an agreement with the named developer to pay for the infrastructure improvement.

¹ Unless otherwise indicated, Chapter and Section references are to the Montgomery County Code (2004).

If the appropriation resolution is silent on the method of acquisition, the process for financing the infrastructure available to the Executive Branch will depend on whether the infrastructure improvement has been built at the time the County enters into a binding agreement to pay for the improvement. If the infrastructure improvement has not been constructed, the Executive Branch must follow the usual competitive process for acquiring construction services under Chapter 11B; although in some cases the department responsible for acquisition of the infrastructure may be entitled to seek to award the construction contract under a sole source justification. In the case of road construction, the Executive Branch may also elect to use a road participation agreement authorized under Section 49-6.

If the infrastructure improvement has been completed when the County is prepared to expend public funds for the infrastructure, the Executive Branch should enter into an implementation agreement to reimburse the developer for the infrastructure. The reimbursement amount should not exceed the lesser of the amount of the appropriation, the cost of the infrastructure, or a fair and reasonable price for the infrastructure as determined by a cost/price analysis.

BACKGROUND

Bill 44/46-92, enacted in 1994, declares that the purpose of a development district is to provide “financing, refinancing or reimbursement for the cost of infrastructure improvements necessary for the development of land in areas of the County of high priority for new development...” *See* Section 14-2(a). The infrastructure improvements to be financed are identified by a Council resolution creating the district. *See* Section 14-9. The County may fund the financing of infrastructure improvements by levying special assessments, special taxes, fees, and charges on property in the development district. *See* Section 14-10(a). The County may issue special obligation debt to raise the funds to finance the infrastructure improvements; the special assessments, taxes, and charges serve as the revenue source for paying the bondholders. *See* Chapter 14, Article IV. Section 14-16(b) provides, “Unless otherwise authorized by law, bidding and construction of infrastructure improvements must follow the County’s usual process for constructing capital improvements.” Section 14-16(c) then goes on to provide, “The County may contract with another public agency or (subject to competitive procurement laws) a private party, including the Revenue Authority or owners of property in a development district, to construct any infrastructure improvement when significant cost or time savings are likely to result.”

Some of the language of Chapter 14 (and its legislative history) indicates that the Council anticipated that construction of infrastructure improvements might begin after the issuance of bonds.² But there is no language in Chapter 14 that mandates that development districts must follow that sequence—*i.e.* create the development district; issue bonds; levy taxes to pay bondholders; and then construct the infrastructure improvements using the bond proceeds. In fact, there is language that indicates that

² *See, e.g.* Section 14-9(e)(3) (resolution creating district must create a contingency account for unexpected cost overruns); Section 14-16(b) (infrastructure improvement construction must begin promptly when bond proceeds become available).

construction of infrastructure improvements might occur before County funds the infrastructure. As noted, Section 14-2(a) indicates that the purpose of a development district is to provide “financing, refinancing or **reimbursement**” (emphasis added) for infrastructure improvements.

There is a chicken and egg conundrum associated with constructing the infrastructure after issuance of bonds. From a financial perspective, construction of infrastructure before the issuance of bonds is desirable, because bonds must be secured by a tax imposed on real property in the development district. A secure revenue stream and realistic tax rate is generally not possible until much of the property in the development district has been improved. In fact, bonds secured by a revenue stream based on undeveloped land (sometimes referred to as “dirt bonds”) may be difficult to market. Moreover, most subdivision plans require that infrastructure be built concurrently with the construction of homes and commercial buildings. These factors make the construction of infrastructure improvements before issuance of the bonds a likely sequence. In fact, this sequence generally seems to have occurred in the Germantown development district as well as the Clarksburg Town Center development district.

DISCUSSION

Appropriation Resolution.

The Counsel must appropriate development district funds before the funds may be used to finance infrastructure improvements. Charter Section 311 provides, “No expenditure of County funds shall be made or authorized in excess of the available unencumbered appropriations therefor.” Generally, the appropriation for an infrastructure improvement would be found in a Council resolution appropriating money to fund the capital budget. Capital budget appropriations are made project-by-project. Each project is described in a project description form (PDF). In the aggregate the PDF’s form the Capital Improvement Program (CIP). Some capital budget appropriation resolutions condition expenditure of funds on compliance with all requirements set out in the PDF associated with the appropriation. For example, the Capital Budget Resolution for FY-06 provides, “The expenditure of funds for each item in the capital budget must comply with all restrictions and requirements in the project description form for that item, as the form is contained in the approved CIP as amended by this resolution”

The Court of Appeals has concluded that the approved Montgomery County budget resolution is a legislative enactment that has the status of a law. In *Haub v. Montgomery*, 353 Md. 448 (1999) the Court of Appeals rejected a challenge by certain merit employees to a decision to contract out certain functions in the County government.³ This outsourcing initiative affected approximately 156 positions which were slated for termination. The affected employees argued that they had a right to grieve the decision to contract out the programs; the Merit System Protection Board had a right to stop the outsourcing initiative of the Executive; and the Charter required that

³ These functions included certain Health and Human Services programs, recreation center cleaning, and food services at correctional facilities.

merit employees must implement County programs. The Merit Board rejected the employees' arguments, and the employees appealed. Before the Court of Appeals could rule on the employees' appeal, the outsourcing program was approved in the FY-96 budget.

In rejecting the employees' challenge, the Court of Appeals held that the adopted budget was a "legislative enactment" that trumped any earlier enacted law and would prevail over other already enacted County laws of a more general applicability. The Court stated, "When, however, the decision to contract out or privatize specific functions is made as a later legislative enactment, by the same legislative body which earlier had enacted the collective bargaining ordinances and merit system ordinances, the later enactment prevails to the extent of any inconsistency." 353 Md. at 462. The Court further stated, "Specific provisions of the later enacted budget, stating that specified work be contracted out or privatized, would control over the general and earlier enacted provisions of Section 33-12(b) and the regulations thereunder." 353 Md. at 463.

Therefore, under the holding in *Haub* the Council, through the appropriation process, could establish the means for financing the infrastructure improvements in the development district. For example, the FY-07 CIP includes the Clarksburg Town Center Development District: Roads (PDF #500423). The PDF states, "This project provides for acquisition of completed road improvements in the Clarksburg Town Center Development District that will be constructed by the developer and subsequently acquired by the County." Unlike the FY-06 Capital Budget Resolution, the FY-07 Capital Budget Resolution does not condition the Clarksburg Town Center appropriation on compliance with the Clarksburg Town Center PDF; of course, if the FY-07 Clarksburg Town Center appropriation lapses at the end of the fiscal year because a binding agreement to reimburse the developer has not been executed, the Council could in the FY-08 Capital Budget Resolution make the Clarksburg Town Center appropriation subject to compliance with the Clarksburg Town Center PDF. In that event, the Executive Branch would negotiate an implementation agreement to reimburse the developer for the infrastructure improvements after the infrastructure has been built.

Chapter 11B, Contracts and Procurement.

Section 11B-3 provides, "This Chapter must apply to every expenditure of public funds, irrespective of their source, by the County... to acquire goods, services, or construction except as otherwise provided by County, State or federal law." Thus, if the County finances the infrastructure improvements by entering into a contract to construct the infrastructure, the County's procurement law will apply.

Generally, construction contracts must be awarded by competitive sealed bids—assuming the appropriation resolution does not provide otherwise. *See* Section 11B-9; Section 11B-14(a)(4) (a noncompetitive contract may be awarded if a proposed contractor has been identified in a grant or appropriation resolution approved by the Council). However, a construction contract may be awarded on a noncompetitive basis if only one source can meet the County's minimum valid needs, including timeliness of performance. *See* Section 11B-14(a). In the context of constructing infrastructure improvements, a developer already on site constructing homes and local streets may be the only available

source for construction of needed infrastructure in a timely manner. If a noncompetitive contract award is made to construct infrastructure improvements, the contract amount must be supported by a price or cost analysis. *See* Section 11B-26 and Procurement Regulation, Section 10.1.

Road Participation Agreements.

Section 49-6 authorizes the County Executive to enter into a contract with the developer of a subdivision “to participate in the cost of street, sidewalk, gutter, curb or drainage construction in a public street or road dedicated to the public use.”⁴ Therefore, under Section 49-6, the Executive Branch may enter into a contract with a development district developer who is constructing roads in the development district to pay the developer to construct a road listed as an infrastructure improvement in the resolution creating the development district.

Section 49-6 provides an alternate acquisition avenue to the requirements of Chapter 11B, Procurement. As noted, Section 11B-3 provides that the Procurement Chapter applies to the expenditure of public funds to acquire construction services “except as otherwise provided by County, State or federal law.” But Section 49-6 would not be available to acquire non-road infrastructure improvements such as parks, water mains, libraries, pumping stations, *etc.*

Reimbursement for Completed Infrastructure.

If the infrastructure has been constructed, the County should enter into an implementation agreement to reimburse the developer who constructed the infrastructure. The amount reimbursed should not exceed the lesser of: 1) the unencumbered appropriation available for the infrastructure; 2) the developer’s cost; or 3) an amount that a cost/price analysis would indicate is fair and reasonable.

Infrastructure improvements (such as a road, pumping station, water main, bikeway, *etc.*) are attached to land and so are considered real property. Blacks Law Dictionary defines real property as “land and anything growing on, attached to, or erected on it...” *See also Comptroller of the Treasury v. Stuart Investment*, 312 Md. 1 (1988). (Bulk liquid storage tanks are real property because the tanks were permanent and substantial improvements to the land.) Consistent with this common law, Section 11B-46, which addresses acquisition of real property by the County, defines real property as “land and improvements to land”.

Section 11B-46(b) requires the County to follow a certain process when the County will “acquire real property by purchase, condemnation, or a lease for more than 5

⁴ Bill 48-06, enacted in July 2007 with an effective date of October 14, 2007, renumbers Section 49-6 as Section 49-4. New Section 49-4 will read “The County Executive, on behalf of the County, may contract with any person, who is building a real estate development or subdivision in the County, to participate in the cost of any street, sidewalk, bikeway, gutter, curb or drainage construction, landscaping, traffic control device, or placement of utilities or amenities in a street or road dedicated to public use.”

years duration.”⁵ The question then arises whether an agreement to reimburse development district funds to a developer for constructed infrastructure is governed by Section 11B-46. We think not.

Section 11B-46 does not apply to a development district implementation agreement because the infrastructure improvements belong to the County; thus there is no real property for the County to acquire.

A developer must construct certain infrastructure improvements, like roads and parks, as a condition of subdivision approval. See Section 50-35(k). This infrastructure, once constructed, need not be acquired by the County by deed, easement, or other form of conveyance, because the infrastructure will be constructed on land already dedicated to public use. Section 50-15(a) provides that land designated on a subdivision plat for public use, like roads and parks, “are hereby declared to be forever dedicated to public use, and shall not thereafter on any pretext whatsoever, be altered or taken for private use....” Section 50-24(a) requires a developer to construct roads and sidewalks in each new subdivision under the specifications of the County road construction code; section 50-24(h) mandates that “all public improvements shall be completed or assured as provided in subsection (g) of Section 50-37.” Section 50-37(g) provides that a developer must obtain permits and any required bonds “as will ensure final proper completion and installation of all public improvements as required in Section 50-24....” Section 49-39(h) provides that a permit to construct a road cannot be issued unless the right-of-way has been acquired by the County or dedicated to public use.⁶ Section 49-42 mandates that a road constructed by a developer be thereafter maintained at County expense, if the County finds that the road has been constructed according to County construction standards.⁷ Thus, infrastructure constructed as part of the subdivision process becomes by operation of law available for public use and also becomes the maintenance obligation of the County. Hence, no instrument conveying an interest in real property is necessary to consummate the County’s assumption of control and responsibility for infrastructure constructed on property dedicated to public use as part of the subdivision process.

Generally, the County is not obligated to pay the developer for the constructed infrastructure.⁸ But if the infrastructure is listed as an infrastructure improvement under a

⁵ Section 11B-46 requires the County to advertise once each week for not less than two weeks in at least one newspaper of general circulation in the County any proposal to acquire real property. The advertisement is intended to provide the public with an opportunity to comment on the proposed acquisition. But Section 5(B) Maryland Ann. Code Article 25A appears to require that a proposed acquisition of real property must be advertised for three (3) successive weeks in one or more newspapers of general circulation published in the County. As a matter of caution, therefore, the County Attorney’s Office has advised that an advertisement proposing to acquire real property should be run for three (3) successive weeks, not the two successive weeks required under Section 11B-46(b). In addition, Section 11B-46(d) requires the County to post a sign on the property to be acquired for at least ten (10) days before the deadline for receiving public comment. Like the newspaper advertisement, the sign is intended to provide the public with an opportunity to comment on the proposed acquisition.

⁶ Bill 48-06 renumbers this section as 49-36(h).

⁷ Bill 48-06 renumbers this section as 49-38(c).

⁸ See *Francis O. Day v. Montgomery County*, 102 Md. App. 514, (1994), *disapproved on other grounds Harford County v. Town of Bel Air*, 348 Md. 363 (1998) (paving contractor who is not paid by developer cannot recover from County under an unjust enrichment claim); Restatement, *Restitution*, § 2.

Council resolution adopted under Section 14-9 and the Council has appropriated funds in the capital budget for the infrastructure, the Executive Branch must implement the appropriation by reimbursing the developer.

As noted, we recommend that the Executive Branch enter into an implementation agreement with the developer. The agreement should set the amount of reimbursement which should not exceed the lesser of: 1) the appropriation; 2) the actual cost of the construction; or 3) a fair and reasonable price for the infrastructure.⁹

We believe the amount of reimbursement to be paid the developer is subject to these three limitations for the following reasons: Charter Section 311, as already noted, provides that no expenditure of County funds may be made in excess of the amount appropriated. Thus, the amount to be reimbursed the developer cannot exceed the appropriation for that purpose. The other two limitations concerning not exceeding the lesser of the developer's cost or a fair and reasonable price for the infrastructure arises out of the legal nature of an appropriation. An appropriation is an authorization to spend government money for a **public** purpose. *See Bayne v. Secretary of State*, 283 Md. 560 (1978) (an appropriation of public funds is a legislative act "whose primary object is to authorize the withdrawal from the state treasury of a certain sum of money for a specified public object or purpose to which such sum is to applied.") There is no public object or purpose to be achieved by providing a developer with a windfall by reimbursing the developer more than the infrastructure cost incurred by the developer; nor is there a public purpose to be achieved by reimbursing a developer more than a fair price for the infrastructure thereby rewarding waste.

To avoid confusion, we hasten to add that there is a public purpose to financing infrastructure that a developer is required to provide as part of the subdivision process. As Section 14-2(a) notes, the purpose of a development district is to provide "financing, refinancing or reimbursement for the cost of infrastructure improvements necessary for the development of land in areas of the County of high priority for new development...." There is no doubt that providing an incentive to development in certain parts of the County targeted for development achieves a public purpose. *See Snowden v. Anne Arundel County*, 295 Md. 429 (1983) (establishment of fund to reimburse employees for legal expenses incurred in defending themselves against criminal charges serves a public purpose); *Wilson v. County Commissioners of Allegany County*, 273 Md. 30 (1974) (promoting economic development serves a public purpose).

We trust you will find this analysis helpful. As always, if you have concerns or questions, please let us know.

cc: Thomas J. Dagley, Inspector General
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⁹ In determining a fair and reasonable price, the department responsible for negotiating the agreement should refer to the cost and price analysis procedure set out in Chapter 11B, Procurement.

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