THE ETJ OPT-OUT BILL

A SEISMIC SHIFT IN LAND DEVELOPMENT.

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This past legislative session, Senate Bill 2038, also known as the "ETJ opt-out bill," was passed into law. It allows for landowners to unilaterally petition to have their land removed from a city's extraterritorial jurisdiction, the unincorporated area contiguous to the corporate boundaries of a city in which cities are granted limited authority over development.[1] This change to the law has dramatically shifted the dynamics of development throughout the state in notable ways. Specifically, the ETJ opt-out bill shifts the negotiating power from cities to developers.

Prior to SB 2038, cities enjoyed strong negotiating power because cities are required to consent to the creation of municipal utility districts within their corporate limits or ETJ (MUD consent), which are typically used by developers to finance public infrastructure. Cities must also approve development plats and construction plans for development within their ETJ.[2] In the course of these approvals, cities tied numerous and often unrelated conditions and requirements to the MUD consent and plat and plan approvals, which ultimately led to months, if not years, of negotiations with city staff. This process sometimes resulted in higher costs and stalled development in these areas, and the ETJ opt-out bill was the Legislature's direct response to these obstacles. Notably, the bill garnered bipartisan support.[3] For Democrats, the issue was housing affordability. For Republicans, this bill was viewed as a limited government and landowners' rights initiative.

The ETJ opt-out bill has flipped bargaining power from the cities to the developers. As a result, cities are now having to take the proverbial "carrot" instead of "stick" approach when it comes to working with developers. To retain development in their ETJ, cities must incentivize developers to stay. Those incentives typically include one or more of the following:

1. Access to capacity in existing water supply and wastewater treatment facilities;
2. Expedited plat and plan review;
3. Economic incentives in the form of credits against development fees or tax or water system revenue rebates;
4. City funding of offsite water and sewer mains or road improvements.

In exchange, the developers opting to remain in a city's ETJ can provide the city with the ability to annex their development into the city limits in the future. In 2019, the Legislature dramatically restricted cities' ability to annex land unilaterally.[4] One of the exceptions to that limitation is the situation in which an ETJ MUD enters into a strategic partnership agreement with the city that provides for future annexation.[5] In such a situation, a city can annex without holding an election in the area to be annexed.

In regions with abundant groundwater, like Houston, it is not enough for cities to simply have water and wastewater capacity available. They must provide those services faster and cheaper than the developers can build their own systems. Intuitively, cities should have an advantage here with scale and ability to borrow at cheaper rates than the private sector. In practice, however, this has not been the case. Cities sometimes gravitate toward larger, more complex water plants and wastewater plants, often with the most expensive options, and construct them in phases that are far too large to meet near-term demand. They effectively then price themselves out of the market for new development. The ETJ opt-out bill forces cities to sharpen their pencils with a real eye toward efficiency, cost-savings, and cooperation when it comes to design, construction, and financing this public infrastructure.

In fact, cities are competing with one another to keep or add land to their ETJ. Because the landowner now has the

right to get out of one ETJ and petition into another, the landowner can effectively “swap” ETJ if a city provides enough incentive to do so. In one instance in particular, a developer with property within the ETJ of three different cities opted to put all of its land into the ETJ of the city of Sugar Land after Sugar Land offered them the easiest and most cost-effective access to water and sewer services.

To compete in this new environment, cities must be reasonable with their development requirements, thoughtful with expansions of their facilities, and creative in the financing of their public infrastructure. Cities have to be open to working with developers collaboratively and using tools like water districts, Texas Local Government Code Chapter 380 agreements, tax increment reinvestment zones, and Texas Water Development Board financing options to make developing in their ETJ attractive.

The ETJ opt-out bill, which allows landowner initiated unilateral removal from a city’s ETJ within approximately 45 days of submission of a simple signed petition, has resulted in more development subject to county regulations—which are more limited in scope to those of cities. Counties generally regulate drainage, plan and plat approvals,[6] and road standards. Similar to some cities, however, some counties have attempted to regulate development beyond their legal authority and impose exactions on developers by interpreting their limited powers broadly. The regulation of minimum lot sizes through minimum lot frontage requirements under the guise of their general authority to regulate subdivisions under Chapter 232 of the Texas Local Government Code[7] is one such example of overstepping regulations.

As of this writing, a number of cities have sued the state to declare SB 2038 unconstitutional on a number of grounds: (1) unconstitutional delegation of legislative powers to private property owners; (2) unconstitutionally vague; (3) lacks notice and hearing provisions; and (4) conflicts with other state law that requires city consent to a reduction of its ETJ.[8] With cross motions for summary judgment filed and oral arguments held at the end of May, a ruling may happen this summer. Regardless of that ruling, appeals will likely be taken, and the Supreme Court of Texas will ultimately have to resolve the issue. With housing affordability remaining an important policy for both parties, additional legislation next session is likely, whether the law is struck down or upheld.

A year into this new legal framework, the practical long-term implications remain to be seen. Numerous landowners are submitting petitions for removal from city ETJs and cities are joining to file suit against the state claiming the law is unconstitutional. Cities are also sending updated ETJ maps showing removal of land for which a petition was submitted. If the ETJ opt-out bill withstands legal challenge, the question remains: Will it result in more affordable housing of expected quality, or will it instead open the door to more county regulations—perpetuating the cycle the bill was intended to break? One thing is clear: The negotiating power between cities, counties, and developers is not the same, and the cities that adapt to this new framework the fastest have the opportunity to expand their territory, as Sugar Land has done. **TBJ**

NOTES

1. *See* Texas Local Government Code, Chapter 42.
2. *See* Texas Local Government Code, Chapter 212.
3. *See* SB 2038; Sponsors: Four Democrats; 27 Republicans. Final vote counts per chamber: Senate (20/11); House (127/18).
4. *See* House Bill 347 (2019).
5. *See* Texas Local Government Code, Chapter 43, Section 43.0751.
6. *See* Texas Local Government Code, Chapter 232.
7. *See Town of Annetta South v. Seadrift Development, L.P.,* 446 S.W.3d 823 (Tex. App.—Fort Worth 2014, pets. denied).
8. *See City of Grand Prairie v. The State of Texas,* Cause No. D-1-GN-23-007785 (261st Judicial District 2023), https://www.tml.org/DocumentCenter/View/3993/20231025-Plaintiffs-Original-PetitionFinal-File-Stamped-_removed.

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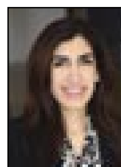

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