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Super - Liens to the Rescue? A Case Against Special Districts in Real Estate Finance

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I. Introduction

Henry and Claire, newly arrived to the state, eagerly drive into the gated and well-adorned front entrance of the Beau Chateaux subdivision.[1] With wide eyes, they marvel as they pass the carefully manicured lawns filled with meticulously pruned hedges, the architecturally pleasing homes on spacious lots, and the French chateau-style neighborhood community center, still in the early stages of construction, promise to feature a restaurant, tennis courts, a sprawling golf course, and a luxuriously ornamented swimming pool.[2] The couple pulls into their driveway and smiles with satisfaction at the beauty, the quality, and the lifestyle that they have bought into when they purchased a home here in Beau Chateaux. They especially feel lucky to have gotten into this development in its early stages, attributing their great deal on the purchase price of their home to their timeliness. Both are confident that the many empty lots and pre-built homes throughout Beau Chateaux will soon be filled with residents just like them.[3]

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1. *See, e.g.*, *We're the Face of Poverty: This Is the Tale of Our Two Baton Rouges*, BATON ROUGE BUS. REP. (Nov. 14, 2011), http://www.businessreport.com/article/were-the-face-of-poverty-this-is-the-tale-of-our-two-baton-rouges (last visited Mar. 30, 2015) ("That's because readers of this publication tend to be business executives, tend to be in an upper-middle-income bracket or higher, tend to be white and tend to live in faux French Country homes, many along Highland Road and almost all well south of Florida Boulevard.") (on file with the Washington and Lee Law Review).

2. *See generally* Setha M. Low, *The Edge and the Center: Gated Communities and the Discourse of Urban Fear*, 103 AM. ANTHROPOLOGIST 45 (2001) (describing the creation and aspects of American gated communities).

3. *See* MARY G. SNYDER, FORTRESS AMERICA: GATED COMMUNITIES IN THE UNITED STATES 29 (1999) ("They also speak about a feeling of community, or a friendly community, or having neighbors like themselves, where they feel 'at

Neither Henry nor Claire has to worry about yard care, as others handle that service. Nor do they have to worry about continued construction of the community center, as that too is being taken care of. Next week there is scheduled to be a wine and cheese art walk in the neighborhood park, but Henry and Claire do not have to purchase tickets or worry about paying for the food or spirits at the event. All of these expenses are taken care of beforehand, not by the payment of their homeowner's association dues, but rather through the payment of their annual ad valorem property tax bill.

Importantly, Beau Chateaux is not just any private residential subdivision; rather, it has the special designation of being a special taxing district.[4] The local city council has been feverish in its desire to lure innovative developers to the area and to spur growth in the local economy.[5] In order to satisfy this economic development hunger, the city council agreed to create for the developer a special geographic designation, co-terminus with the property boundaries of Beau Chateaux, that would imbue a board of directors—appointed through a special statutory scheme—to charge annual property tax assessments against each of the individual parcels within the development.[6] The board, whose members were appointed by the city council at the recommendation of the developer, then used the promise of the future revenues generated from these assessments to issue a substantial number of bonds, which were then sold to investors to raise capital for the project.[7]

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home.'").

4. *See generally* 1 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 2:33 (Clark A. Nichols et al. eds., 3d ed. 2013) (explaining the functions, purposes, and legal status of legislative special districts vis-à-vis municipal corporations).

5. *See* Christopher K. Odinet, *Fairness, Equity, and a Level Playing Field: Development Goals for the Resilient City*, 50 IDAHO. L. REV. 217, 220 (2014) (arguing that competition between cities to draw residents and to spur growth has increased since the Great Recession).

6. *See generally* 1 GELFAND, STATE AND LOCAL GOV'T DEBT FIN. § 11:17 (2d ed.) (discussing the history, purpose, function, and creation of special legislative districts).

7. *See id.* ("Today, special authorities and special districts finance, construct and operate a wide range of programs and facilities. Generally, their capital projects are financed by revenue bonds, which are usually backed by

The developer, eager to attract potential buyers like Henry and Claire, used the proceeds from the sale of these bonds to support a significant portion of the costs of building Beau Chateaux. Everything from the many cobblestone streets, the environmentally friendly sanitary sewer system, the water distribution network, the parterre and antique rose laden community park, and even the expenses associated with the neighborhood center with its restaurant, tennis courts, golf course, and pool were paid for by the bonds issued by Beau Chateaux's special taxing district.[8]

The developer felt quite pleased with his work[9] because—although he did have to personally borrow a decent amount of money from his regular lending institution, Realty Bank, in order to fund the initial purchase of the land—the vast majority of the capital needed to build the improvements and infrastructure for Beau Chateaux was provided for by the special district. And because it was the special district that issued the bonds and guaranteed the debt from the future assessments, he was not personally liable for any of these obligations.[10] Feeling so confident of his success, the developer went ahead and had the board of the district issue enough bonds so that he could not only complete phase one of Beau Chateaux as planned, but could also

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service charges (e.g., bridge tolls, utility fees)." (citations omitted)).

8. *See generally id*. *See, e.g.*, Dale White, *Homeowners in Failed Tax District Find Themselves in a Bind*, HERALD-TRIBUNE (Mar. 8, 2013), http://www.heraldtribune.com/article/20130308/ARTICLE/130309612 (last visited Mar. 30, 2015) ("To pay for [infrastructural improvements], some developers obtain the state's permission to set up CDDs. The special tax districts function as a government body that floats bond issues to pay for that infrastructure. The district boards add annual assessments to property tax bills to pay off the bond issues.") (on file with the Washington and Lee Law Review).

9. It should be noted that usually developers operate through a business entity, such as a limited liability company, partnership, or corporation, and the issue typically arises when such an entity constitutes a thinly capitalized firm. *See* William J. Rands, *The Closely Held Corporation: Its Capital Structure and the Federal Tax Laws*, 90 W. VA. L. REV. 1009, 1069–70 (1988) (describing situations in which corporations are closely linked to a single developer and have little capital). However, for purposes of this Article, I refer to the developer in the male gender.

10. *See* White, *supra* note 8 ("In other words, property owners within a community development district assume a debt beside their mortgage and property taxes. They are obligated to pay off the district's bonds.").

go ahead and finish phase two and most of phase three as well, all at the same time. People would come far and wide to make a home in this idyllic setting. After all, who would not want to live in a community where the homes are consistently beautiful, the yards immaculate, the streets reminiscent of old Europe, with gourmet food trucks lining the pre-fabricated village square, and where children are free to play throughout the community under the watchful eye of the private neighborhood security service?[11] And to live in this lush fairytale-style paradise, one need only pay a little extra on their property tax bill.[12]

During the first year, after most of the phase one construction at Beau Chateaux was complete, all seemed to go well, and new homeowners like Henry and Claire began purchasing houses within the development on a fairly routine basis, but then the developer started to get a little worried. Although a decent number of parcels were now owned by third parties like Henry and Claire, a substantial number of the lots had yet to be sold and were still owned by the developer. He had been able to handle not only payments on the debt service for the real estate loan to Realty Bank, but also payment of the many individual property tax bills for the unsold parcels only by dipping into cash reserves from the project. Surely as word spread of the luxuries of Beau Chateaux hordes of willing buyers would be forthcoming. But, unfortunately, the housing market began to take a serious downturn in 2007 and 2008.[13] Home

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11. *See generally* SAMER BAGAEEN, OLA UDUKU & SASKIA SASSEN, GATED COMMUNITIES: SOCIAL SUSTAINABILITY IN CONTEMPORARY AND HISTORICAL GATED DEVELOPMENTS (2010); SEASIDE INST., VIEWS OF SEASIDE: COMMENTARIES AND OBSERVATIONS ON A CITY OF IDEAS (2008); ROBERT A.M. STERN, DAVID FISHMAN & JACOB TILOVE, PARADISE PLANNED (2013); DHIRU A. THADANI, VISIONS OF SEASIDE: FOUNDATION/EVOLUTION/IMAGINATION BUILT AND UNBUILT ARCHITECTURE (2013).

12. *See* White, *supra* note 8 ("The district boards add annual assessments to property tax bills to pay off the bond issues.").

13. *See* JAMES R. BARTH, TONG LI, WENLING LE, TRIPHON PHUMIWASANA & GLENN YAGO, THE RISE AND FALL OF THE U.S. MORTGAGE AND CREDIT MARKETS: A COMPREHENSIVE ANALYSIS OF THE MARKET MELTDOWN 50–51 (2009) (illustrating the rapid decline in the subprime share of home mortgages); Joseph William Singer, *Foreclosure and the Failures of Formality, or Subprime Mortgage Conundrums and How to Fix Them*, 46 CONN. L. REV. 497, 500 (2013) ("Cheered on by President George W. Bush's call for an 'Ownership Society,' these mortgages helped fuel a housing bubble that burst in 2007, plunging us into the

prices began to fall tremendously, and that included those homes and parcels within Beau Chateaux.[14] The developer started to get worried because, although he could decrease the asking price for the homes and therefore take a hit to his profits, he could not do anything to decrease the annual costs of owning the property due to the ad valorem tax bill.[15] The following year saw the downfall of many financial institutions,[16] some of which had been known to purchase special district bonds like those of Beau Chateaux, and the mortgage market began to collapse as credit dried up.[17]

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worst recession since the Great Depression." (citing Raymond C. Niles, *Eighty Years in the Making: How Housing Subsidies Caused the Financial Meltdown*, 6 J.L. ECON. & POL'Y 165, 175–76 (2010))).

14. *See* Aline van Duyn, *US Housing Market Hit by 'Walkaways'*, FIN. TIMES (Feb. 22, 2010), http://www.ft.com/cms/s/0/a93abcea-1fe7-11df-8deb-00144feab49a.html#axzz3VuscmCML (last visited Mar. 30, 2015) ("The high level of foreclosures in the US—the handing over of homes to banks that lent people money to buy them—has been a huge burden on the economy, has kept house prices on a downward spiral and has resulted in misery and anxiety for millions of people.") (on file with the Washington and Lee Law Review); Roger Lowenstein, *Walk Away From Your Mortgage!*, N.Y. TIMES (Jan. 7, 2010), http://www.nytimes.com/2010/01/10/magazine/10FOB-wwln-t.html (last visited Mar. 30, 2015) ("[F]oreclosures depress the neighborhood and drive down [house] prices.") (on file with the Washington and Lee Law Review).

15. *See Ad Valorem*, BLACK'S LAW DICTIONARY 60 (9th ed. 2009 ("[Latin 'according to the value'] (of a tax) proportional to the value of the thing taxed." (brackets in original)).

16. *See* Brooksley Born, *Foreword: Deregulation: A Major Cause of the Financial Crisis*, 5 HARV. L. & POL'Y REV. 231, 233 (2011) ("These developments created the conditions that caused the collapse of the housing bubble to turn into a major financial crisis."); Chad D. Emerson, *A Troubled House of Cards: Examining How the Housing and Economic Recovery Act of 2008 Fails to Resolve the Foreclosure Crisis*, 61 OKLA. L. REV. 561, 569–70 (2008) (describing legislative efforts to save crumbling financial institutions); Singer, *supra* note 13, at 521 (illustrating the causes and dangers of insolvent banks); Gregory Zuckerman, Susanne Craig & Serena Ng, *Goldman Sachs Charged With Fraud*, WALL ST. J. (Apr. 17, 2010), http://www.wsj.com/articles/SB100014240527023034913045751879208456 70844 (last visited Mar. 30, 2015) (explaining the involvement of Goldman Sachs in the financial crisis) (on file with the Washington and Lee Law Review).

17. *See* Singer, *supra* note 13, at 509 ("The entire business model switched from long-term repayment of mortgage loans by those who were likely to be able to make the payments (with foreclosure available as an unusual and secure backup in case of default) to a short-term market dependent on risk borrowers and compliant investors." (citing JAMES R. BARTH ET AL., *supra* note 13, at 50–51 (2009))).

Residents of Beau Chateaux, like Henry and Claire, began to sense that things were not going well. Construction of the community center had stopped months ago. The yards and the public park were not being kept up with the frequency that they once were and social events had vanished entirely. Not only that, but twice in the past year they had seen an increase in their special assessments. At first they assumed the Beau Chateaux special district board wanted to build up reserves or might have needed a bit more to finance the construction of the golf course and center, but they were now beginning to suspect that something else might be afoot. What made matters worse was that no one was purchasing any more lots or homes within the development. Whole portions of the neighborhood assumed a zombie-like feel as structures remained empty and yards became overgrown.[18]

And the residents were right to be worried. The developer had used up all of his reserves and could not make the next payment of special assessments on the many unsold parcels in the community that he still owned. Soon, Henry, Claire, and their neighbors were given notice that the developer had declared bankruptcy and that Realty Bank was proceeding to foreclose on the many portions of the development still subject to its original mortgage. A month later, with no one paying the special assessments on that year's property tax bills, the district as a whole went into default on its bonds. The bondholders, not willing to sit by and allow Realty Bank to exercise its mortgage rights to the prejudice of theirs, also foreclosed on their security rights. As

18. *See* Les Christie, *Zombie Foreclosures Still Weighing on Housing Markets*, CNNMONEY.COM (Mar. 13, 2014), http://money.cnn.com/2014/03/13/real_estate/zombie-foreclosures/ (last visited Mar. 30, 2015) ("RealTrac reported Thursday that foreclosure filings fell 27% year-over-year in February to a new seven-year low, indicating that the pace of filings have returned to normal levels since the foreclosure crisis. However, lingering problems loom.") (on file with the Washington and Lee Law Review); *see also* Navideh Forghani, *Vacant Homes Hurting Neighborhoods*, ABC15 ARIZ. (Aug. 5, 2013), http://www.abc15.com/news/region-phoenix-metro/central-phoenix/vacant-homes-hurting-neighborhoods (last visited Mar. 30, 2015) ("Some investment homes aren't re-sold right away so they can sit vacant for long stretches of time, sometimes becoming neighborhood eye-sores. Investors are buying up homes and just letting them sit there. Some aren't maintaining the properties at all.") (on file with the Washington and Lee Law Review).

part of the special district legal structure, the nonpayment of special assessments charged against the parcels within the development—much like with traditional real property taxes—created a lien on the individual lots. These, in turn, could be foreclosed upon like any other security device.[19] And, also like real property taxes, this lien—although the product of an entirely private enterprise, used entirely for profit, and the financing of which was controlled entirely by the developer—is accorded superpriority over and above any pre-existing security rights.[20] This means that although Realty Bank has a first lien in the form of its mortgage on the development due to having advanced the upfront capital to purchase the land, the lien of the special taxing district is given superior status and, when foreclosed, would wipe out and completely destroy the lien of the bank.[21]

As the bondholders and the bank each commenced foreclosure proceedings and fought out their various rights in court, Henry, Claire, and their neighbors began to realize the severity of their situations. The conditions in Beau Chateaux continued to deteriorate. The streets and sidewalks, as well as the community park, became overgrown with weeds and littered with debris. The community center, only half constructed, began to crumble and pose a safety hazard. The golf course became overrun with vermin and wild animals. And the many empty homes were constantly subjected to vandalism, consistent with the slew of recent reports of criminal activity throughout the neighborhood. Moreover, this malaise spread to adjoining

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19. *See, e.g.*, LA. REV. STAT. § 33:9039.29(A) (2014) ("These benefit special assessments shall be a lien on the property against which assessed until paid and shall be enforceable in like manner as parish taxes."); *see also* Miller, *infra* note 119, at 147–49 (discussing public facilities districts in California); Galvan, *infra* note 114, at 3049–57 (discussing MUDs in Texas); Griffith, *infra* note 31, at 963–68 (discussing Florida's community development districts, Georgia's infrastructure development districts, Colorado's public improvement districts, Delaware's special development districts, and New Mexico's public improvement districts).

20. *See generally supra* note 19 and accompanying text.

21. *See* RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 4.9(b) (1997) ("A holder of a junior interest who purchases real estate at the foreclosure sale of any senior lien on that real estate acquires title free and clear of the interest of the holder of the equity of redemption and of any interest that was junior to the foreclosed lien.").

neighborhoods that, although not benefiting from a special taxing district themselves, started to feel the negative effects of the nearby failing Beau Chateaux development. Buyers, retailers, and developers began to bolt from the area as properties become undesirable, values fell, and the community acquired the reputation of being one in decline.

Newspapers began to report that other real-estate-related special taxing districts like Beau Chateaux in the surrounding counties and across the state—as well as in other states—were similarly failing in massive numbers as billions of dollars of bonded indebtedness defaulted or were close to default.[22] Cities and towns across the United States that used special taxing districts for more altruistic purposes—such as to incentivize development in depressed areas or to provide critical human services to areas that are economically disadvantaged—were advised by their legal counsel that federal housing regulators have stated that because of the super liens that these districts can produce, Fannie Mae and Freddie Mac will not support residential lending for properties that are located within or may be located within such districts.[23] Without the ability to obtain conventional financing, many community and economic development groups have been forced to abandon the use of special taxing districts as a way to finance critical infrastructure

22. *See, e.g.*, White *supra* note 8 (describing the failure of special districts caused by the mortgage crisis); *see also* Gary Fineout, *Florida Communities Pay Attention to a Tax Case*, N.Y. TIMES (July 9, 2009), http://www.nytimes.com/2009/07/10/us/10florida.html?_r=0&adxnnl=1&adxnnlx=1422115201-fB+y9qlj+rQuj3h5IS/mJQ (last visited Mar. 30, 2015) (describing the impact of tax disputes on Florida special districts) (on file with the Washington and Lee Law Review); Lauren Ritchie, *Community Development Districts in Lake and Across Florida in Financial Crisis*, ORLANDO SENTINEL (Aug. 22, 2010), http://articles.orlandosentinel.com/2010-08-22/news/os-lk-lauren-ritchie-bond-defaults-0820100822_1_community-development-districts-bond-issue-richard-lehmann (last visited Mar. 30, 2015) (arguing that community development districts unfairly saddle homeowners with massive debt) (on file with the Washington and Lee Law Review).

23. *See, e.g.*, Prentiss Cox, *Keeping PACE?: The Case Against Property Assessed Clean Energy Financing Programs*, 83 U. COLO. L. REV. 83, 103 (2011) ("On August 31, 2010, the GSEs issued guidance statements indicating that they would not purchase mortgage loans if the homeowner had a PACE obligation unless the PACE program was structured so that the PACE lien was subordinate to the first lien mortgage loan.").

in areas where conventional lending is too risky to attract lenders at reasonable rates, if at all.[24]

Henry and Claire now desire more than anything to sell their home and get as far away as possible from Beau Chateaux. Unfortunately, they cannot afford to purchase a new home until this one has sold but, due to the neighborhood's decline and the extremely high property tax bill, they cannot find a willing buyer. Also, because they purchased their home at the height of the housing bubble, they cannot afford to take a hit on the sale and thus cannot go down on their price. With so many of the parcels within the development being unmarketable, Beau Chateaux becomes a haven for blight and joins the line to the guillotine with the many other failed developments that have resulted from the unregulated abuse of real-estate-related development special taxing districts.[25]

While constructed above in the form of a narrative hypothetical, the plight of Henry, Claire, and the residents of Beau Chateaux is all too real. Stories like these have become common across the United States, especially in places where the ills from the housing bubble's burst were felt most severely, like in Florida.[26] Special taxing districts, for so long tied to traditional governmental functions like providing fire and police safety, water distribution, sewer services, and the development of economically distressed areas or important commercial centers, have become the instrumentalities of private real estate developers—and with tragic results.[27] As cities and municipalities

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24. For a discussion of the demise of another type of special taxing district, the Property Assessment Clean Energy special district, see Michael A. Wrapp, *Property Assessed Clean Energy (PACE): Victim of Loan Giants or Way of the Future?*, 27 NOTRE DAME J.L. ETHICS & PUB. POL'Y 273, 284 (2013) ("The depth of the controversy over PACE programs became fully apparent when, with the supervision of the FHFA, Fannie Mae and Freddie Mac flatly refused to purchase any mortgages burdened by a PACE lien.").

25. *See* Ritchie, *supra* note 22 (illustrating the impact of the mortgage crisis on Florida communities utilizing special districts); White, *supra* note 8 (same); *see generally* Finout, *supra* note 22 (same).

26. *See* sources cited *supra* note 25 (describing the severity of the economic fallout in Florida).

27. *See* DAVID L. CALLIES, AMERICAN LAW INSTITUTE, PUBLIC PRIVATE PARTNERSHIPS IN THE AGE OF ECONOMIC DISTRESS: TAX INCREMENT FINANCING, SPECIAL ASSESSMENTS AND REDEVELOPMENT 19 (2012), http://files.ali-

across the United States became zealous in their desire to attract new residents and to land economic development projects, they became more willing—or dare say, enthusiastic—to bestow their guarded public powers and prerogatives into the hands of private developers to aid them in obtaining easy, fast cash.[28] Unfortunately, with such power and such self-interest in the unchecked hands of private individuals, many developers overextended themselves (or rather their districts), which, coupled with the housing crisis, caused the entire real estate special taxing district scheme to come crashing down.[29]

But this failure has not only meant that people like Henry and Claire find themselves in a hard spot. The ripple effect on the surrounding community—which can sometimes constitute an entire municipality or county—can be substantial.[30] Economic depression begets more economic depression as potential investors, residents, and businesses retreat or run from these deteriorating areas, leaving them to become ghost towns filled with struggling businesses and haunted neighborhoods where

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cle.org/thumbs/datastorage/skoobesruoc/pdf/TSUF02_chapter_02_thumb.pdf ("The quintessential TIF [tax-increment financing] project, however, is a public infrastructure project that encourages private investment . . . that would otherwise be the cost of the private developer."); *see also* FELDMAN, ROLAPP & ASSOCS., ADVANTAGES AND DISADVANTAGES OF COMMUNITY FACILITIES DISTRICTS FOR ISSUER, DEVELOPER, AND ULTIMATE PROPERTY OWNER 1–2, http://www.fieldman.com/PDFs/Advantages-Disadvantages%20of%20CFDs.pdf [hereinafter FELDMAN ROLAPP] (listing the advantages and disadvantages of special districts to issuers and developers).

28. *See* Odinet, *supra* note 5, at 220 (describing the need for municipalities to compete with each other and provide incentives for development).

29. *See* White, *supra* note 8 ("As happened with Gran Paradiso, developments were started in what was becoming a declining housing market and the buyers needed to pay off CDD debt did not materialize, Lehmann said."); Ritchie *supra* note 22 ("Today, Florida has 294 of these powerful districts that have borrowed billions by issuing bonds, and 123 of those—42 percent—are either defaulting or aren't collecting enough money to make their payments . . . ."); FELDMAN ROLAPP, *supra* note 27, at 1 (listing risk of bond default through no fault of the issuer as a disadvantage of community facilities districts).

30. *See generally* Collin Gordon, *Blight the Way: Urban Renewal, Economic Development, and the Elusive Definition of Blight*, 31 FORDHAM URB. L.J. 305 (2004).

many homes sit vacant or abandoned by their underwater owners.[31]

Further, this process undermines the basic notions of vested property rights without implicating constitutional considerations. The lender whose loan enables the developer to buy the land traditionally receives a first priority mortgage on the property.[32]

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31. *See* Janice C. Griffith, *Special Tax Districts to Finance Residential Infrastructure*, 39 URB. LAW. 959, 979 (2007) ("Even though the enabling IDD statutes in Florida and Georgia provide that the debt of an IDD does not constitute an obligation of the state . . . . [t]he municipal bond market and credit rating agencies' practices may link the district's creditworthiness to the locality and possibly the state."); Paul Donsky, *Volume of 'Subdivision' Vacant Lots Overwhelms Banks*, ATLANTA JOURNAL-CONSTITUTION (Aug. 17, 2009), http://m.ajc.com/news/business/volume-of-subdivision-vacant-lots-overwhelms-banks/nQKdL/ (last visited Mar. 30, 2015) ("These idled, 'zombie' subdivisions can be found across metro Atlanta, but they're most prevalent in outer-ring suburban areas. Selling them has proven tough, with some properties sitting on the market for months on end without even a nibble.") (on file with the Washington and Lee Law Review); Becky Johnson, *Development Done Right: Failed Projects Open Door for Those Taking the Long View,* SMOKY MOUNTAIN NEWS (June 11, 2014), http://www.smokymountainnews.com/component/k2/item/13096-development-done-right-failed-projects-open-door-for-those-taking-the-long-view (last visited Mar. 30 2015) ("With the development in foreclosure, lot owners were in limbo and afraid to build homes. The roads were deteriorating, and any hope of a quick rebound in the real estate market had been dashed.") (on file with the Washington and Lee Law Review); Becky Johnson, *Picking Up the Pieces Proves Costly, Time-Consuming for Local Governments,* SMOKY MOUNTAIN NEWS (June 3, 2014), http://www.smokymountainnews.com/component/k2/item/13005-picking-up-the-pieces-proves-costly-timeconsuming-for-local-governments (last visited Mar. 30 2015) ("Developers took down their shingles, folded up their tents and walked away, many of them bankrupt and forclosed on, with no means to polish off the vast network of dirt roads, culverts and cleared land they's engraved on the mountains during the short-lived heyday.") (on file with the Washington and Lee Law Review); JC Reindl, *Oakland County Wants Action at Site of Gigantic Failed \$2-Billion Development 'Eyesore'*, DETROIT FREE PRESS (Mar. 10, 2013), http://archive.freep.com/article/20130310/BUSINESS06/3031100218/Oakland-County-wants0action-at-site-of-gigantic-failed-2-billion-development-eyesore (last visited Mar. 30, 2015) ("Conceived as a 42-billion sprawling and upscale town center for Oakland County, Bloomfield Park today is a collection of half-constructed buildings, dirt roads and unused parking garages that stand as ruins of the Great Recession and the overly exuberant real estate investment decisions that preceded it.") (on file with the Washington and Lee Law Review).

32. *See* STUART M. SAFT, COMMERCIAL REAL ESTATE TRANSACTIONS § 9:19 (3d ed. 2013) ("The mortgage will also indicate that the indebtedness is secured by any buildings and improvements now or hereafter constructed on the land . . . .").

Except in rare cases, the lender would refuse to make that loan without a first priority lien,[33] which ensures that the debt will be paid before others whose liens or other interests in the property arose after the first mortgage loan was made.[34] However, the law gives the special taxing district lien, imbued with public power but used for purely private purposes, superpriority.[35] Even though the developer's nonpayment of the assessments occurs only after the bank first obtains its mortgage, the mortgage is nonetheless inferior to the lien.[36] While this type of subordination has merit in the context of general property taxes imposed by a municipality for purposes of education, police protection, and other public services, it represents an extreme injustice in the context of purely private, profit-driven developments.[37] Despite this, there is no requirement that the special district or the municipality that created it pay just compensation to the first secured party for the impairment to its rights in the property.[38]

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33. *See id.* (explaining that mortgages usually contain affirmations that the property is free from other liens except those elaborated in a schedule annexed to the mortgage).

34. *See* RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 7.1 (1997) ("A valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law.").

35. *See, e.g.*, LA. REV. STAT. § 33:9039.29(A) (2014) ("These benefit special assessments shall be a lien on the property against which assessed until paid and shall not be enforceable in like manner as parish taxes."); *see also* Griffith *supra* note 31, at 969 ("The district board determines the amount of assessments, which constitute a lien against the property until paid.").

36. *See* Griffith, *supra* note 31, at 969 ("The district board determines the amount of the assessments, which constitute a lien against the property until paid.").

37. *See* 4 JOHN MARTINEZ, LOCAL GOVERNMENT LAW § 23:11 (2014) ("Absent a state constitutional provision to the contrary, the state legislature has great leeway in fashioning classifications between and among various types of property for revenue raising purposes provided that it has not acted in a palpably arbitrary or invidiously discriminatory fashion.").

38. *Id.* § 21:17 (citing Buettner v. City of St. Cloud, 277 N.W.2d 199 (Minn. 1979)). Here you should say whether the mortgage lender knows, when making the loan, that the collateral is part of a special taxing district. If the lender knows that the loan is being made on collateral that is within or may be within a special taxing district, then the lender can take into account the risk of subordination with its eyes open and can build that risk into the interest rate it charges.

And lastly, the use of special taxing districts for private real estate developments has a wider adverse effect on community lending as a whole. Because real estate lenders cannot rely, as they have traditionally in the past, upon a first lien mortgage, many will no longer make loans for projects in areas that are subject to special taxing districts, no matter what legitimate and larger societal good they serve.[39] Further, because of the potential to be primed by the district's super lien, financial institutions at the secondary mortgage market level—who play such a critical role in making a liquid residential mortgage market possible—will likely refuse to purchase mortgages that are secured by properties within special districts, something that has already occurred in recent, similar situations involving PACE financing.[40] While this has the potential to kill off effectively the use of purely private real estate development special districts, it will have the unintended consequence of eliminating the use of these financing tools in scenarios where they are truly warranted, such as in projects that improve poor neighborhoods or economically depressed areas where no conventional lender will extend credit.[41] By doing so, a whole sector of viable community development financing will be utterly abolished.[42] Although special taxing districts have received significant consideration by legal scholars in the past, this Article helps draw a more focused

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39. *See, e.g.*, Jonathan B. Wilson, Maura A. Marcheski & Elias B. Hinckley, *The Great PACE Controversy*, 25 PROB. & PROP. 38, 39 (2011) ("Mortgage underwriters feared that loans secured by mortgages would become subordinate to PACE liens and as a result would not be readily sellable on the secondary mortgage market."); *see also* Jeffrey Hoops, *Setting the PACE for Energy Efficiency: The Rise, Fall, and (Potential) Return of Property Assessed Clean Energy*, 89 WASH. U. L. REV. 901, 902 (2012) ("Specifically, the FHFA believes that PACE creates unacceptable risk for lenders in general and its regulated entities in particular because most PACE legislation gives PACE assessment liens priority over pre-existing mortgages in the event of homeowner default.").

40. *See* Ian M. Larson, *Keeping PACE: Federal Mortgage Lenders Halt Local Clean Energy Programs*, 76 MO. L. REV. 599, 600 (2011) (describing the refusal of Fannie Mae and Freddie Mac to purchase mortgages encumbered by PACE liens).

41. *See id.* at 601 ("Missouri lenders, legislatures, homeowners, environmentalists, and small businesses have thus been unable to move forward with a PACE program since federal lenders halted the initiative nationwide.").

42. *See supra* note 40.

attention to the blatant abuses and negative effects caused by the use of special taxing districts in the purely private real-estate-development setting. Part II discusses the current economic climate of cities and municipalities across the country—those entities that serve as the primary creator of special taxing districts—in the wake of the Great Recession. This includes exploring the effects that the financial crash had on their well being as well as the continued economic and financial pressures faced by municipalities.[43] Part II also highlights the reinvigoration in recent years of the importance of local government as a problem solver and a driver of economic and social prosperity—popularly called the "resilient city" movement.[44] Part III gives an overview of the history and uses of special taxing districts throughout American history, including a discussion of the development of special taxing districts used for real estate development purposes.[45] It also includes a discussion of how, in light of the increasing intensity of economic development competition between cities, these particular special taxing districts have become tools that local government leaders use to lure private investors and businesses to their locale.[46] Part IV peels away the gilt and hype behind these special districts when used for purely private development by pointing out their negative effects on vested property rights, the larger surrounding community, and the wider real estate financing market, particularly with respect to community lending.[47] After analyzing these adverse consequences, Part V investigates the ways in which the use of real estate special taxing districts can be better regulated and curtailed by pointing out the drawbacks to seeking a private, contract-based remedy as well by trying to prescribe statutorily their usage.[48] This Article concludes by advocating that an equitable jurisprudential approach—in the form of a two-

43. *Infra* Part I.

44. *See generally infra* Part II.

45. *See generally infra* Part III.

46. *See generally infra* Part III.

47. *See generally infra* Part IV.

48. *See generally infra* Part V.

pronged test—be adopted by courts to help better police the legitimate use of special taxing districts.[49]

II. Special Taxing Districts and the Reinvigoration of Localism

Over the past several years, cities and other municipalities have been tested and strained by changing political winds and powerful economic and financial pressures.[50] The financial and housing crisis of 2007 and 2008, followed by the Great Recession, caused a tremendous mistrust in the federal government.[51] Many viewed poor policymaking and a loose regulatory system, all dominated and controlled at the federal level, as having been significantly, if not chiefly, responsible for allowing greed, corruption, and vice to settle into the American economy and which ultimately brought it crashing down.[52]

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49. *See generally infra* Part VI.

50. See Odinet, *supra* note 5, at 227 ("While cities have enjoyed a prominent place in the story of flourishing throughout history, these institutions have also faced their share of trials and tribulations." (citing JAMES HOWARD KUNSTLER, THE GEOGRAPHY OF NOWHERE: THE RISE AND DECLINE OF AMERICA'S MAN-MADE LANDSCAPE 9–15 (1993))).

51. *See id.* at 227–28 (explaining the "trials and tribulations" of cities during the Great Recession).

52. *See* Singer, *supra* note 13, at 500–01 (arguing that deregulation contributed significantly to the recession); David Leonhardt, *Washington's Invisible Hand*, N.Y. TIMES (Sept. 26, 2008), http://www.nytimes.com/2008/09/28/magazine/28wwln-reconsider.html (last visited Mar. 30, 2015) ("The current financial crisis is frequently called the worst since the Great Depression. And [financial regulation legislation in the 1990s] is often cited as a cause, even by some of its onetime supporters.") (on file with the Washington and Lee Law Review); Glenn Kessler, *Obama's Claim that the Bush Tax Cuts Led to the Economic Crisis*, WASH. POST (Oct. 1, 2012), http://www.washingtonpost.com/blogs/fact-checker/post/obamas-claim-that-the-bush-tax-cuts-led-to-the-economic-crisis/2012/09/30/06e8f578-0a6e-11e2-afff-d6c7f20a83bf_blog.html (last visited Mar. 30, 2015) (analyzing the impact of the Bush tax cuts on the Great Recession) (on file with the Washington and Lee Law Review); Stan Liebowitz, *The Real Scandal: How Feds Invited the Mortgage Mess*, N.Y. POST (Feb. 5, 2008), http://nypost.com/2008/02/05/the-real-scandal/ (last visited Mar. 30, 2015) ("From the current hand-wringing, you'd think that the banks came up with the idea of looser underwriting standards on their own, with regulators just asleep on the job. In fact, it was the regulators who relaxed these standards—at the behest of community groups and 'progressive' political forces.") (on file with the Washington and Lee Law Review).

In the wake of these events, political tolerance for centralized decision-making—and spending—has declined significantly.[53] In its place has been a rise of an intense focus on cities and local governments.[54] But municipalities have, in many ways, a heavier yoke to carry in the wake of the financial downturn and, amid these increasing demands to be society's new problem solvers, local governments are faced with intense pressures from all sides.[55] It is through these economic and social pressures that local government decision-making has been steered precariously toward the creation of more and more special taxing districts as an instrument for

53. See Eric Liu, *Bypass Washington, Save America,* CNN (Sept. 26, 2013), http://www.cnn.com/2013/09/26/opinion/liu-government-shutdown/ (last visited Mar. 30, 2015) (arguing that local governments have adapted local policy solutions in the face of federal inefficiency) (on file with the Washington and Lee Law Review); Joy Wilke, *Americans' Belief That Gov't Is Too Powerful at Record Level* (Sept. 23, 2013), http://www.gallup.com/poll/164591/americans-belief-gov-powerful-record-level.aspx (last visited Mar. 30, 2015) ("[60% of Americans] believe the federal government has too much power . . . . At least half of Americans since 2005 have said the government has too much power. Thirty-two percent now say the government has the right amount of power. Few say it has too little power.") (on file with the Washington and Lee Law Review); *43% Say Local Government Better Than Feds, States*, RASMUSSEN REP. (Feb. 16, 2010), http://www.rasmussenreports.com/public_content/politics/general_politics/february_2010/43_say_local_government_better_than_feds+states (last visited Mar. 30, 2015) ("Forty-three percent (43%) of U.S. voters rate the performance of their local government as tops compared to its counterparts on the state and federal level.") (on file with the Washington and Lee Law Review).

54. *See* John Parisella, *The Rising Importance of Major Cities*, AMERICAS QUARTERLY (Oct. 6, 2010) http://www.americasquarterly.org/node/1859 (last visited Mar. 30, 2015) ("Like it or not, cities and their first administrators are being called upon to play a greater role on issues affecting more than their actual jurisdictions and this is a welcomed development.") (on file with the Washington and Lee Law Review); Sam Casella, *Let Cities Be Cities*, PLANETIZEN (Nov. 26, 2001, 12:00 AM), http://www.planetizen.com/node/34 (last visited Mar. 30, 2015) ("History teaches us that cities are crucial to civilization.") (on file with the Washington and Lee Law Review); David Lowenthal, *Visible Cities*, HARV. DESIGN MAG. 78 (Winter/Spring 2001), http://www.harvarddesignmagazine.org/issues/13/visible-cities (last visited Mar. 30, 2015) (arguing that the Great Recession has provided challenges and opportunities for cities to implement local policy solutions) (on file with the Washington and Lee Law Review).

55. *See* Parisella, *supra* note 54 ("Like it or not, cities and their first administrators are being called upon to play a greater role on issues affecting more than their actual jurisdiction and this is a welcome development.").

economic, financial, and cultural viability, which has, in turn, served as an invitation for abuse and poor policymaking.[56]

A. The Effects of the Economic Crisis on Local Governments

In order to understand why special taxing districts have been, and will likely only continue to be, such an attractive tool for use by local governments in fulfilling their new post-Recession destiny, it is necessary to appreciate how the economic crisis has affected municipalities across the country.[57]

Cities have enjoyed a prominent role in human society throughout the ages.[58] The American city is no different, and, in fact, many of the greatest moments in the history of the United States—the rise and fall of great political movements, the birth of the industrial age, the genesis of new technologies, and the rise of a higher quality of life—took place amid the hustle and bustle of her cities.[59]

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56. *See id.* ("It is becoming increasingly obvious that large cities are centers of economic, political, cultural, and community life. Together, they are doing more to increase their efforts to share best practices on safety, environmental, educational and community integration issues."); Odinet, *supra* note 5, at 219 ("General governmental power and authority has shifted between a model favoring a more centralized federal or state government and a structure focused more on the autonomy and control of local governments.").

57. THE PEW CHARITABLE TRUSTS, THE LOCAL SQUEEZE: FALLING REVENUES AND GROWING DEMAND FOR SERVICES CHALLENGE CITIES, COUNTIES, AND SCHOOL DISTRICTS 1 (June 2012) http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/American_Cities/Pew_Cities_Local_Squeeze.pdf [hereinafter LOCAL SQUEEZE] (describing the concurrence of a decline in state aid and property taxes with the rise of demand for government services).

58. *See* MCQUILLIN, *supra* note 4, § 1:4 ("Historically, urban life has afforded almost unlimited opportunities to attain the highest living and intellectual standards."); Odinet, *supra* note 5, at 218 ("Few societal institutions have been as integral to the growth and prosperity of human civilizations as the city."). *See generally* ALAN EHRENHALT, THE GREAT INVERSION AND THE FUTURE OF THE AMERICAN CITY (2013); T.R. GLOVER, THE ANCIENT WORLD: A BEGINNING (1937); MASON HAMMOND, THE CITY IN THE ANCIENT WORLD 33 (1972).

59. *See generally* JANE JACOBS, THE DEATH AND LIFE OF GREAT AMERICAN CITIES (1961); RICHARD LAWTON, THE RISE AND FALL OF GREAT CITIES: ASPECTS OF URBANIZATION IN THE WESTERN WORLD (1989); DONALD L. MILLER, CITY OF THE CENTURY: THE EPIC OF CHICAGO AND THE MAKING OF AMERICA (1996).

1. The Financial Faring of Cities in the Great Recession

Although cities have faced a bevy of different challenges over the years—everything from the era of decay after the decline of the industrial era to the attempted renaissance brought about by the Housing Act of 1954[60] and other federal legislation—the most recent wave of challenges came from the crash of the financial markets and the effects of the Great Recession.[61] Specifically, the recession brought about a sharp decline in local government tax revenues,[62] as massive streams of tax revenue that cities had come to expect suddenly dried up or became consumed by new and unforeseen financial obligations.[63] City services ranging far across the spectrum were privatized in an effort to shift financial responsibility and accompanying costs.[64] Such services included things as varied as outsourcing the operation of the city zoo, trash pick-up, and even 911 emergency call centers.[65] Budget cuts brought about massive layoffs of local government employees

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60. Housing Act of 1954, 83 Pub. L. No. 560, 68 Stat. 590.

61. *See generally* PETER HALL, CITIES OF TOMORROW: AN INTELLECTUAL HISTORY OF URBAN PLANNING AND DESIGN IN THE TWENTIETH CENTURY 13–46 (1988). *See* Odinet, *supra* note 5, at 219 ("Similarly, the city . . . has often been subjected to the ever-changing economic winds which, when combined with poor local government decision making, can crush a municipality under the weight of reduced revenue streams and burdensome financial obligations." (citing Howard Chernick, Adam Langley & Andrew Reschovsky, *The Impact of the Great Recession and the Housing Crisis on the Financing of America's Largest Cities* 1–3 (Univ. of Wis.-Madison, Working Paper Series No. 2011-008, 2011))); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425 (1993).

62. *See* LOCAL SQUEEZE, *supra* note 57 (analyzing decreased local government revenue streams by using states like Michigan and Ohio as case studies).

63. *See id.* ("Many [states, cities, and counties are] in a fiscal vise, squeezed on one side by reduced state aid and property tax income—which together make up more than half of local revenues—and growing demand for services on the other.").

64. *See id.* (explaining that some states, like New Jersey, have proposed privatization as a solution to revenue problems).

65. *See id.* ("Others have restructured departments or consolidated services with other localities. The city of Olathe, Kansas, recently partnered with surrounding Johnson County to build and run a single 911 dispatch facility, saving the city more than $300,000 in annual staffing and equipment costs.").

such as teachers, policemen, and firefighters, all in an effort to stabilize city finances.[66]

The reason behind these drastic measures stemmed from diminishing tax revenues.[67] By one report, states were hit with a 13% decline in local government revenues at the end of 2009.[68] In the past when cities had been faced by low tax revenues, they were able to obtain third-party funding from state and federal coffers,[69] but the Great Recession brought this back-stop system to a halt as both the state and the federal government were hit with their own financial woes.[70] State legislatures could barely

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66. *See id.* (citing Lisa Allmendinger, *Saline School Board Approves 'Structurally Deficient' $51.5 Million Operating Budget for 2011–2012,* ANN ARBOR NEWS (June 29, 2011), http://www.annarbor.com/news/saline-school-board-approves-final-515-million-operating-budget/ (last visited Mar. 30, 2015) (on file with the Washington and Lee Law Review)); Tracy Carloss, *Cleveland Mayor Says All Departments Affected by City Layoffs*, NEWSNET5 (May 16, 2011), http://www.newsnet5.com/news/local-news/cleveland-metro/cleveland-mayor-says-all-departments-affected-by-city-layoffs (last visited Mar. 30, 2015) ("Through a combination of layoffs, attrition, hiring freezes, and furloughs, local governments shed half a million jobs, or 3.4 percent of their overall workforce, between September 2008 and December 2011, with half of this loss coming from the education sector.") (on file with the Washington and Lee Law Review).

67. *See* Odinet, *supra* note 5, at 228–29 (providing examples of municipalities that laid off employees to compensate for decreased revenue).

68. *See id.* at 229–30 (citing Lucy Dadayan, *Tax Revenues Surpass Previous Peak but Growth Softens Once Again: Local Property Tax Collections Resume Modest Gains*, 87 ROCKEFELLER INST. 1, 2 (2012), http://www.rockinst.org/pdf/government_finance/state_revenue_report/2012-04-19-SRR_87.pdf ("For instance, by the end of 2009, the majority of states were seeing a 13% decline in local tax revenues from prior years while budget shortfalls continued to rise.").

69. *See* LOCAL SQUEEZE, *supra* note 57 ("Federal funds that have helped localities address these problems in the past also are beginning to shrink or expire."); Tracy Gordon, *A Great Recession Brief: State and Local Budgets and the Great Recession*, BROOKINGS (July 2012), http://www.brookings.edu/research/articles/2012/12/state-local-budgets-gordon (last visited Mar. 30, 2015) ("State and local revenues often decline in an economic downturn, but federal grants may help to offset these losses.") (on file with the Washington and Lee Law Review).

70. *See* Wendy Edelberg, *Automatic Reductions in Government Spending—aka Sequestration*, CONG. BUDGET OFF. (Feb. 28, 2013), https://www.cbo.gov/publication/43961 (last visited Mar. 30, 2015) (referencing a "fiscal tightening" on the part of the federal government) (on file with the Washington and Lee Law Review); Nicholas Johnson, *The State and Local Drag on the Recovery*, HUFFINGTON POST (Jun. 6, 2012),

afford to meet their own financial obligations and were similarly on a cutting spree to balance their budgets.[71] At the federal level, public opinion raged against additional borrowing and thereby cut off the possibility of a federal bailout for America's cities.[72]

2. Trying to Do More with Less and Less

Services that had long been seen as essentially tied to the function of local government—such as the provision of safety and fire services, roads and transportation, libraries, housing, and public health[73]—were all subjected to deep draconian cuts.[74] And

http://www.huffingtonpost.com/nicholas-johnson/the-state-and-local-drag-on-the-recovery_b_1581753.html? (last visited Mar. 30, 2015) (arguing that layoffs by state and local governments slowed recovery from the recession) (on file with the Washington and Lee Law Review); Odinet, *supra* note 5, at 230 (claiming that federal funding has waned since the Great Recession).

71. *See* Gordon *supra* note 30, at 333 (explaining legislators' intent to restrain state tax-increment financing following the Great Recession).

72. *See* Odinet, *supra* note 5, at 230 (citing Jonathan D. Salant & Kathleen Miller, *Federal Spending Cuts Slice Contract Awards 11% in 2013*, BLOOMBERG (Jan. 15, 2014), http://www.bloomberg.com/news/2014-01-16/federal-spending-cuts-slice-contract-awards-11-in-2013.html (last visited Mar. 30, 2015) (on file with the Washington and Lee Law Review)); Carrie Dann, *Congress Passes Massive Funding Bill to Keep Government Open (For Now)*, NBC NEWS (Jan. 16, 2013), http://nbcpolitics.nbcnews.com/_news/2014/01/16/22328978-congress-passes-massive-funding-bill-to-keep-government-open-for-now (last visited Mar. 30, 2015) ("The emerging political climate that favored reducing deficits and cutting spending resulted in less direct aid to local governments from Congress and federal departments.") (on file with the Washington and Lee Law Review).

73. *See* Odinet, *supra* note 5, at 226

> [U]rban centers began to expand their offerings to include a wide array of amenities and services that had been little known prior to this period. "A simple list of urban functions and the date when they first began to be performed illustrates [this] problem-solving approach[:] . . . provision of a municipal water system (1822); sewage and sanitary works (1823); street railways (1832); public education (1840); municipal police force (1844); public parks (1840's); tax-supported public libraries (1854); bridges financed by municipal funds (1863); public health boards (1866); outdoor lighting (1880's)." (citation omitted).

74. *See* LOCAL SQUEEZE, *supra* note 57 ("[Cleveland, following budget shortfalls,] also shut down five fire companies. With six trash crews eliminated, residents waited longer to have their refuse and recycling collected."); Rob Gurwitt, *As States Cut Aid, Localities Learn to Do Less with Less*, PEW

even as the economy began to emerge from the downturn and private enterprise began to feel optimistic, dark storm clouds remained over local governments.[75] Rainy day funds had long since been raided to maintain essential city services, and there were no more disposable public assets to sell in order to plug holes with one-time monies.[76] Sales-tax revenues remained low, and the housing crisis's impact on property taxes produced a lagging effect such that, although the crash occurred in 2007–2008, the impact of the reduced tax monies only truly began to be seen in 2010.[77] And lastly, many new financial obligations are on the horizon, such as debt service due on public-works bonds and retirement-system debt.[78]

Against this backdrop of financial austerity, little outside support, and increasing expectations, cities have become ravenous for new forms of tax revenues.[79] Almost all policy debates within the hallowed halls of city government across the country are consumed with ways in which new jobs, new developments, and new sources of tax monies can be lured, enticed, maintained, and augmented within the particular jurisdiction.[80]

CHARITABLE TRUSTS (Oct. 3, 2011), http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2011/10/03/as-states-cut-aid-localities-learn-to-do-less-with-less (last visited Mar. 30, 2015) ("[In Michigan], cities have cut back on services, laid off workers, put off hiring, merged departments and positions, and renegotiated labor contracts.") (on file with the Washington and Lee Law Review).

75. *See* Odinet, *supra* note 5, at 243 ("As cities emerge from the wake of the economic downturn, the landscape has been altered and cities are being forced to adapt and re-tool so as to meet this new world order.").

76. *See id.* at 229 (referencing the use of "rainy day funds" to deal with economic emergencies).

77. *See id.* at 231 ("Although cities vary in their dependence upon sales taxes, these revenue sources declined early in the economic crisis and have continued to remain relatively low.").

78. *See* LOCAL SQUEEZE, *supra* note 57 (listing "exacerbating pension and debt woes" under "long term obligations" of states and municipalities).

79. *See id.* ("Localities' dependence on two faltering sources of revenue—property taxes and state aid—presents profound challenges.")

80. *See id.* (discussing, at length, the efforts of various local governments to reduce spending and increase revenue in innovative ways); Odinet, *supra* note 5, at 236 (describing the attempts by local governments to entice private developers to remain through investment).

B. A Call for Resilience in the Age of Cities

As the country enters—or perhaps better stated, reenters—the Age of Cities, the economic and financial pressures facing America's local government decision makers are extreme, and so are the expectations.[81] As the public has come to view federal leaders (and in some sense, state leaders as well) as having failed to move the country forward and bring about a robust economic recovery,[82] all eyes have now turned to cities.[83]

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81. *See* Odinet, *supra* note 5, at 231–32 (describing the "particularly intense" economic pressures as a result of factors like pensions and retiring employees); *see also* Melissa M. Berry, *Thinking Like A City: Grounding Social-Ecological Resilience in an Urban Land Ethic*, 50 IDAHO L. REV. 117, 118 (2014) (arguing that the gradual shift from rural to urban life has frustrated Americans' attempts to understand their place in the natural world); Jeffrey B. Litwak, *State Border Towns and Resiliency: Barriers to Interstate Intergovernmental Cooperation*, 50 IDAHO L. REV. 193, 194–95 (2014) (linking small towns' difficulties in providing infrastructure with a lack of urban resiliency to crises); John Travis Marshall & Ryan Max Rowberry, *Urban Wreckage and Resiliency: Articulating a Practical Framework for Preserving, Reconstructing, and Building Cities*, 50 IDAHO L. REV. 49, 51 (2014) ("Governments at all levels now face the daunting challenges of rebuilding cities quickly and ensuring they are stronger than before the disaster event."); Andrea McArdle, *Storm Surges, Disaster Planning, and Vulnerable Populations at the Urban Periphery: Imagining A Resilient New York After Superstorm Sandy*, 50 IDAHO L. REV. 19, 19–20 (2014) (illustrating the need for local policy solutions in order to mitigate the extreme damage of disastrous weather); Palma Joy Strand, *Cultivating "Civity": Enhancing City Resilience with Bridging Relationships and Increased Trust*, 50 IDAHO L. REV. 153, 154 (2014) (describing the need to mitigate "the devastating effects on large numbers of people when cities experience environmental and/or social shocks"); Kellen Zale, *Urban Resiliency and the Right to Destroy*, 50 IDAHO L. REV. 85, 85 (2014) ("When considering what makes a city resilient, planners, policy-makers and academics often focus on creating infrastructure to with-stand, respond, and adapt to change, whether environmental, economic or demographic . . . .").

82. *See* Pan Pylas, *Distrust in Government Growing, Survey Finds*, USATODAY (Jan. 20, 2014), http://www.usatoday.com/story/news/world/2014/ 01/20/distrust-in-government-growing/4655111/ (last visited Mar. 30, 2015) ("Trust in elected leaders has fallen sharply, a global survey revealed Monday, citing the protracted budget battle in Washington that nearly saw the U.S. default on its debts and Europe's stuttering response to its debt crisis as key reasons for the drop.") (on file with the Washington and Lee Law Review); *Americans Distrust Government, but Want It to Do More*, NPRNEWS, http://www.npr.org/ programs/specials/poll/govt/summary.html (last visited Mar. 30, 2015) ("The survey found that nearly a quarter of American adults believe that the federal government is a major threat to their personal rights and freedoms, and nearly half think it is at least some threat.") (on file with the Washington and Lee Law Review).

83. *See* Tony Arnold, *Resilient Cities and Adaptive Law*, 50 IDAHO. L. REV. 245,

Public policy decision makers, the media spotlight, scholars, and policy advocates have all focused intensely on local governments and their budding role.[84] By virtue of their size and governance structure, many laud cities as being nimble and deft so as to have the ability to quickly respond to changing market conditions and as being flexible and adaptable so as to be innovative in taking advantage of new opportunities.[85] Further, cities are praised as having "boots on the ground" in terms of understanding how everyday citizens deal with the challenges of this new economic climate.[86] Because the services provided by cities—everything from trash pickup, to making sure there is running water,[87] to keeping schools open for children—are so intimately tied to the everyday experiences of society, cities are viewed as having the unique ability to touch people's lives directly—unlike the more removed and distant state and federal governments.[88]

Local governments also, in theory, react more quickly to the will of their citizens.[89] In other words, because elected officials

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247 (2014) ("The term 'resilient cities' has grown in popularity, and many cities seek to become or remain resilient."); Odinet, *supra* note 5, at 220 (referencing a reinvigorated interest in the power of city governments in recent years).

84. *See* Lowenthal, *supra* note 54 (analyzing the image and perceptions of cities throughout history); Parisella, *supra* note 54 (arguing that the power of city government is growing as evidenced by the ability of mayors to influence national debates on issues like national security).

85. *See* Richard Briffault, *The Rise of Sublocal Structures in Urban Governance*, 82 MINN. L. REV. 503, 503–04 (1997) ("A metropolitan area, thus, functions as a kind of 'marketplace' in which, due to interlocal mobility, residents are more likely to have their preferences satisfied by local government offerings than if comparable public goods and services were offered by higher levels of government.").

86. *See* JAMES WILFORD GARNER, GOVERNMENT IN THE UNITED STATES, NATIONAL, STATE AND LOCAL 5–56 (2011) (describing the form and function of local governments and the benefits of these attributes).

87. *See* Briffault, *supra* note 85, at 503–04 (listing the types of services provided by cities).

88. *See id.* (describing how local governments will be able to provide more efficient services than those "offered by higher levels of government" (citing Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956))).

89. *See id.* (explaining how "interlocal mobility" can lead to residents having their preferences satisfied quickly).

and decision makers live so close and interact so regularly with their constituents, there is more of a direct democratic aspect to the way in which municipalities are governed.[90] And, moreover, cities can serve as laboratories, much in the way states have long been viewed, for testing creative ideas and new ways of encouraging business, handling governance, and providing for the administration of public goods and services.[91]

With such trumpets and fanfare in the background, cities have found themselves in the position of not only trying to survive since the Great Recession, but also newly crowned with the laurels of the hero—an institution best able and ready to be America's problem solvers.[92] One noted commentator states that cities are taking the lead in a myriad of ways that were once unthought of.[93] In fact, many of the policy objectives once advanced chiefly (if not exclusively) by the federal or state governments are now on the municipal policy agenda.[94] These include programs that address climate change or environmental regulations that are implicated by the population densities within their borders.[95] This also includes innovations in the way public transportation is provided so as to meet these population needs.[96]

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90. *See* Nadav Shoked, *Quasi-Cities*, 93 B.U. L. REV. 1971, 2028 (2013) (proposing that quasi-cities will lead to greater self-determination).

91. *See id.* at 2010 (listing the benefits of experimentation at the local level); Sue Siegel, *Cities as Laboratories, Discovering America's Healthcare Solutions*, HUFFINGTON POST (Oct. 2, 2013, 6:00 PM), http://www.huffingtonpost.com/sue-siegel/cities-as-laboratories-di_b_4032819.html (last updated Dec. 2, 2013, 5:12 AM) (last visited Mar. 30, 2015) (supplying examples of how local communities of "colleagues, communities, and companies" have worked together to solve problems with health care) (on file with the Washington and Lee Law Review).

92. *See* Parisella, *supra* note 54 ("It is becoming increasingly obvious that large cities are centers of economic, political, cultural, and community life.").

93. *See id.* ("[C]ities and their first administrators are being called upon to play a greater role on issues.").

94. *See id.* (describing the increased role that cities have had in addressing environmental issues).

95. *See id.* ("Whether it has to do with climate change or other environmental concerns, it is obvious that large cities have greater responsibility.").

96. *See id.* (describing New York City and Montreal's plan for a high-speed rail network).

And certainly in the wake of the financial crisis cities were expected—and often did—take a leading role in attempting to address unemployment issues through engaging in direct or indirect job creation efforts.[97] When crime and unrest was on the rise due to stresses brought about by the downturn, local governments and their partners responded with increased security and innovative safety initiatives, as well as provided counseling and related social services to help people cope with mental illness and with getting back on their feet.[98] And lastly, cities provide the primary showcase for the arts and culture, both of which are so vital to a happy and fulfilled society.[99]

In essence, many scholars and policy advocates often reference the idea of the "resilient" city and its growing role in the post-recession world.[100] Cities are challenged with formulating ways to be resilient and robust in a variety of situations so as to fulfill these newfound expectations.[101]

C. Economic and Public Finance Pressures

But of all the expectations imposed upon local governments in this age of city resiliency, none has taken center stage more than the deep-seated hunger to create jobs and encourage economic development.[102] And this is particularly true with regard to bringing in and fostering new commercial enterprises,

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97. *See id.* (explaining the link between a city's quality of life and job creation).

98. *See id.* (linking the closeness of city officials to their ability to effectively assist citizens).

99. *See id.* (drawing a link between artistic communities and city leadership).

100. For more information on the "resilient" city concept, see *supra* note 81.

101. *See id.* (listing the new challenges that cities face including transportation, climate change, and job creation).

102. *See* DOUGLAS J. WATSON, THE NEW CIVIL WAR: GOVERNMENT COMPETITION FOR ECONOMIC DEVELOPMENT 3–10 (1995) (exploring whether local economic development is appropriate and necessary); Rebecca Hendrick, Yonghong Wu & Benoy Jacob, *Tax Competition Among Municipal Governments: Exit Versus Voice*, 43 URB. AFF. REV. 221, 221–55 (2007), http://uar.sagepub.com/content/43/2/221 (exploring tax competition between cities in the context of sales and property taxes).

retail outlets, and residential developments.[103] Importantly, these developments are essential to a city's bottom line.[104] With tax revenues down so precipitously, creating new streams of tax monies is critical not only to fulfilling the economic recovery expectations imposed upon cities, but also to the survival of the municipality itself.[105] New developments help drive up property values that, in turn, result in higher property tax realizations for the local government.[106] And the development of previously blighted property—from which the city derives little (if any) property revenues at all—is especially beneficial.[107] By extension, as more individuals live, conduct business, and play within the city's borders, sales-tax revenues also rise.[108]

But the fiercest foes that cities face in terms of their economic development efforts are, in fact, one another.[109] Every city faces the challenges associated with decreasing tax revenues and the need to find new sources of public funding.[110] Similarly, all cities are feeling the pressure, both public and political, to step up to the plate as leaders in the American economic recovery.[111]

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103. *See* Watson, *supra* note 102, at 3–8 (explaining the role of local governments in development).

104. *See* Hongbin Cai & Daniel Treisman, *Does Competition for Capital Discipline Governments? Decentralization, Globalization, and Public Policy*, 95 AM. ECON. REV. 817, 817 (2005), (describing the view that "competition for capital motivates governments to reduce their corruption, waste, and inefficiency, and to provide more growth-promoting infrastructure").

105. *See* Jonathan House, *U.S. Cities Still Reeling from Great Recession*, WALL ST. J. (Oct. 23, 2013, 6:17 PM), http://blogs.wsj.com/economics/2013/10/23/u-s-cities-still-reeling-from-great-recession/ (last visited Mar. 30, 2015) (explaining how cities post-recession have struggled to raise their revenue to pre-crisis levels) (on file with the Washington and Lee Law Review).

106. *See* Watson, *supra* note 102, at 62–65 (describing how and why states offer tax incentives to industries).

107. *See id.* at 18–31 (listing the development activities that a city can undertake and exploring their impact).

108. *See id.* (describing the benefits of increased economic development).

109. *See* Odinet, *supra* note 5, at 233 (describing the role of competition in the marketplace theory of local government).

110. *See id.* (describing the challenges that a city faces in raising revenue); Watson, *supra* note 102, at 5 (giving reasons why cities focus on economic development).

111. *See* Parisella, *supra* note 54 (explaining how cities have taken an increased role in public policies).

With only so many economic development opportunities to go around, cities often compete with one another for the same projects.[112] In the waning days of negotiations to land a large industrial plant, a mega-manufacturing facility, or a new tech headquarters, millions upon millions of taxpayer dollars—both in the forms of direct grants and in various indirect subsidiaries—are offered to the target enterprise.[113]

III. An Arrow in the Arsenal: The Special Taxing District

One type of particularly popular public incentive program used by cities in their quest to boast real estate investment, and the subject of this Article, is the special taxing district like that enjoyed by Beau Chateaux.[114] These are special purpose sub-districts of the larger municipality, which are governed by their own board or commission and operate as a sort of mini-local government that performs certain narrow functions.[115]

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112. *See* Watson, *supra* note 102, at 35–36 ("The competition for the limited number of new jobs created in this country each year, especially in manufacturing, has been an important factor in the increased emphasis on economic development among local governments.").

113. *See* Louise Story, *Michigan Town Woos Hollywood, but Ends Up With a Bit Part*, N.Y. TIMES (Dec. 3, 2012), http://www.nytimes.com/2012/12/04/us/when-hollywood-comes-to-town.html?_r=0 (last visited Mar. 30, 2015) (giving an example of how tax incentives may backfire on a town) (on file with the Washington and Lee Law Review); Louise Story, *Lines Blur as Texas Gives Industries a Bonanza*, N.Y. TIMES (Dec. 2, 2012), http://www.nytimes.com/2012/12/03/us/winners-and-losers-in-texas.html?page wanted=all (last visited Mar. 30, 2015) (finding that Texas gives out more tax incentives than any other state at $19 billion per year) (on file with the Washington and Lee Law Review); Louise Story, *As Companies Seek Tax Deals, Governments Pay High Price*, N.Y. TIMES (Dec. 1, 2012), http://www.nytimes.com/2012/12/02/us/how-local-taxpayers-bankroll-corporations.html (last visited Mar. 30, 2015) (explaining how municipalities are willing to give tax breaks to corporations in the hopes of creating jobs) (on file with the Washington and Lee Law Review).

114. *See* Sara C. Galvan, *Wrestling with MUDS to Pin Down the Truth About Special Districts*, 75 FORDHAM L. REV. 3041, 3042 (2007) (listing the benefits of special districts).

115. *See* Kenneth A. Stahl, *Neighborhood Empowerment and the Future of the City*, 161 U. PA. L. REV. 939, 941–46 (2013) (describing the characteristics of neighborhood zoning districts and of special assessment districts).

The impact of special taxing districts on local government can hardly be understated.[116] One commentator notes that there are roughly as many special districts as there are counties, towns, and cities across the United States combined.[117] Moreover, these districts have achieved roughly $175 billion in expenditures and have incurred approximately $293 billion in debt obligations.[118] Although they have traditionally served a more generic governmental function—such as for roads, bridges, fire services, and the like—they have been increasingly used for an assortment of different purposes.[119] One of these includes their use for real estate development—called for purposes of this Article "development special districts."[120] These districts were meant to provide a financing mechanism whereby the property owners within the geographic district would pay for certain essential infrastructure improvements through long-term debt obligations on each lot in the form of a special assessment on their property tax bills.[121]

However, over time, municipalities, in their desire to aggressively compete and attract investors and developers to their locales, have meted out development special districts to private developers to finance an assortment of private amenities and luxuries that extend far beyond what these districts were originally intended to support.[122] And this public give away has

116. *See* Shoked, *supra* note 90, at 2003–11 (focusing on the normative benefits of quasi-cities including special taxing districts).

117. *Id.* at 1992–93 (citing U.S. CENSUS BUREAU, 2012 CENSUS OF GOVERNMENTS: ORGANIZATION COMPONENT ESTIMATES tbl.2, http://www.census.gov//govs/cog2012).

118. *Id.* at 1977 (citing U.S. CENSUS BUREAU, 2007 CENSUS OF GOVERNMENTS: FINANCE, http://www.census.gov//govs/cog/historical_data& uscore;2007.html.).

119. *See* Stephen R. Miller, *Legal Neighborhoods*, 37 HARV. ENVTL. L. REV. 105, 143–56 (2013) (presenting the increased breadth and scope of tools available to districts in making policies).

120. *See generally id.* (addressing how neighborhoods should be used to address various public policies).

121. *See id.* at 109–13 (chronicling the raise of neighborhoods). *See generally* Callies, *supra* note 27 (describing the uses for tax-increment financing).

122. *See* Griffith, *supra* note 31, at 956–61 (explaining the rapidly expanding role of special districts); Fineout, *supra* note 22 (describing the importance of tax-exempt bonds for one Florida community).

had disastrous results, with portents of greater ills on the horizon.[123]

A. The History and Uses of Special Taxing Districts

Special taxing districts in general have played an important role in the history of the country.[124] These districts are created either directly by the state legislature or, more frequently, by individual local governments.[125] Professor Sara Galvan noted that the first special district appeared in Rhode Island in 1797 in the form of the East Greenwich Fire District and provided fire services to a handful of properties in the area.[126] Their growth since then can hardly be understated.

1. Background and Early Iterations

Special taxing districts continued sprouting up throughout the 1800s to provide financing and to operate "toll roads, canals, and bridges."[127] The general theory behind the creation of these special purpose sublocal governments was that municipalities were not equipped to handle functions with such a specific scope and that these infrastructure items should not be supported by general government funds.[128] Mid-nineteenth century courts espoused this approach as being entirely reasonable and that

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123. *See generally* Ritchie, *supra* note 22; White, *supra* note 13.

124. *See* Shoked, *supra* note 90, at 1977–90 (providing a history of special districts).

125. *See id.* at 1977 (describing how state legislatures may either "pass a special act" or a "general law" in order to create special districts (citing N.Y. GEN. MUN. LAW §§ 975, 990 (McKinney 2012))).

126. *See id.* at 1977 n.22 ("In the Philadelphia area, starting in 1790, special authorities were created for prison administration, port development, public health control, education, and police. By 1850, there were ten such districts." (citing METROPOLITAN ANALYSIS 83 (Stephen B. Sweeney ed., 1958)).

127. *Id.* at 1978.

128. *See id.* (explaining how state legislatures designed funding for projects that were not receiving funds from the "general budget of an existing local government" (citing Bd. of Comm'rs v. Harrell, 46 N.E. 124, 125–27 (Ind. 1897))).

local governments would need from time to time to create "dissimilar corporate authorities, . . . imbued with administrative functions of a nature which could not be properly exercised" by the existing local government.[129]

Of course, the particular power that makes special districts so effective is their ability to levy a tax upon the parcels of land within the bounds of the district itself.[130] In the early days of special taxing districts, numerous lawsuits were filed to challenge this essential characteristic; however, courts quickly rebuffed them.[131] Judges regularly denied claims that the local or state legislature had exceeded its authority in vesting the taxing power in these sublocal structures.[132] As an example, the Illinois Supreme Court, in a particularly sweeping 1869 holding, articulated the growing opinion of state courts across the country with regard to special taxing districts: "There is no prohibition . . . against the creation by the legislature, of every conceivable description of corporate authority, and when created to endow them with all the faculties and attributes of other pre-existing corporate authorities."[133] This broad view of legislative authority included even the power to take certain powers and functions away from existing public entities and reallocate them to special taxing districts.[134] Therefore, functions that were once carried out by local governments could be taken away and thereafter vested in these special purpose districts, without limitation.[135]

129. *See id.* (explaining the rationale that was endorsed by the Illinois Supreme Court (citing People *ex rel.* Wilson v. Salomon, 51 Ill. 37, 50 (1869))).

130. *See id.* at 1979 (describing the districts' power to assess and collect taxes).

131. *See id.* (detailing the legal challenges that legislatures faced).

132. *See id.* (describing two cases where courts upheld the power of the legislature to create special districts).

133. *Id.* (citing People *ex rel.* Wilson v. Salomon, 51 Ill. 37, 50 (1869)).

134. *See id.* (describing how courts came to adopt the view that the legislature could reallocate government functions to other districts (citing Straw v. Harris, 103 P. 777, 781–82 (Or. 1909); State *ex rel.* Baltzell v. Stewart, 43 N.W. 947, 949 (Wis. 1889))).

135. *See id.* at 1980 (explaining the broad view that courts adopted regarding the use of "corporate authorities" (citing Gilson v. Bd. of Comm'rs, 27 N.E. 235, 237 (Ind. 1891); Bowles v. State, 37 Ohio St. 35, 42 (1881))).

2. Challenges and New Deal Proliferation

The next wave of challenges to special taxing districts came in the form of attempts to cabin their powers and to prescribe the limits of what they could accomplish.[136] However, these challenges, like the initial attacks on their creation, were equally unavailing.

Opponents first argued that the constitutional right to vote was inherently violated by the special taxing district structure.[137] The general view was that the Fourteenth Amendment to the U.S. Constitution required one person, one vote, but that special districts' voting power was allocated pursuant to the number of properties one owned within the geographic district.[138] However, courts fired back that special taxing districts operated outside this constitutional rule such that voting power could be allocated based on land or other economic interests, which would otherwise be impossible under the traditional American governmental structure.[139] Moreover, in many cases elections in special districts would be avoided altogether due to the district's enabling legislation that provided for a governing board appointed by the city council or the legislature rather than one popularly elected.[140]

Challengers of special districts also frequently argued that the use of funds raised by a district's bond issuance violated state constitutional limitations on the levying and use of public

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136. *See id.* at 1987–89 (explaining how special districts had more latitude in their powers to restrict the rights of its residents).

137. *See id.* at 1987 (describing how "[s]pecial districts . . . are for the most part exempt" from traditional right to vote jurisprudence).

138. *See id.* (describing how traditional government entities have been subject to the one person, one vote principle (citing Avery v. Midland Cnty., 390 U.S. 474, 476 (1968))).

139. *See id.* (noting that special districts are primarily exempt from this rule (citing Ball v. James, 451 U.S. 355, 370 (1981); Salyer Land Co. v. Tulare Lake Basin Water Storage Dist., 410 U.S. 719, 728 (1973))).

140. *Id.* (citing Sailors v. Bd. of Educ., 387 U.S. 105, 111 (1967); Ehm v. Bd. of Trs. of Metro. Rapid Transit Auth., 251 F. App'x 930, 932 (5th Cir. 2007); Atlanta v. Metro. Atlanta Rapid Transit Auth., 636 F.2d 1084, 1089 (5th Cir. 1981); Van Zanen v. Keydel, 280 N.W.2d 535, 538–39 (Mich. Ct. App. 1979); People *ex rel.* Vermilion Cnty. Conservation Dist. v. Lenover, 251 N.E.2d 175, 177 (Ill. 1969)).

monies.[141] Most state constitutions provide restrictions on how much the state and any of its corporate constituencies can borrow, as well as a proviso that any borrowing must be for a public purpose and that the funds be used in furtherance of a public benefit.[142] However, courts and special district advocates found ways around these constraints as well.[143]

First, the public purpose requirement was interpreted to extend to the amelioration of "ills to be corrected through the use of public funding of measures with even substantial private benefit."[144] These would include things like the improvement of blighted properties and the development of areas that had traditionally been cut off from conventional lending.[145] With regard to complaints about exceeding debt limitations, courts also found ways to distinguish special taxing districts.[146] Special districts were deemed "financially autonomous" because they had their own dedicated revenue stream derived from the special assessments.[147] Because they operated independently from the municipal government, they deserved treatment separate and apart from the restrictions on the local government itself.[148] This jurisprudential exception became known as the public authority doctrine and was used by special taxing districts to avoid legal debt limits that otherwise restricted the borrowing of local and state governments.[149]

141. *See* Callies, *supra* note 27, at 3–4 (providing the background history of tax-increment financing).

142. *See id.* (describing state's efforts to limit districts' taxing power).

143. *See id.* ("Most TIF enabling statutes declare that tax increment bonds are not debt or an obligation of the local government subject to constitutional debt limitation provisions.").

144. *See id.* (citing *In re* House Bill 91S-1005, 814 P.2d 875 (Colo. 1991); Gude v. City of Lakewood, 636 P.2d 691 (Colo. 1981)).

145. *See id.* (explaining that public purpose includes urban renewal).

146. *See id.* ("[S]tate courts have developed judicial doctrines that evade constitutional debt limitations.").

147. *See id.* (defining the public authority doctrine (citing AMDURSKY & GILETTE, MUNICIPAL DEBT FINANCE LAW § 4.12 (2001))).

148. *See id.* ("[T]he debts of independent public authorities are their own and are not the debt of underling local government.").

149. *See id.* (explaining the loophole and lack of electoral accountability created by the public authority doctrine (citing Robert H. Bowmar, *The Anachronism Called Debt Limitations*, 52 IOWA L. REV. 863 (1967); C. Robert

Another jurisprudential exception to the debt-ceiling problem was the special fund doctrine.[150] Under this framework, because the monies generated by the special district were held in a "separate fund," they were not considered to be within the ambit of constitutional debt.[151] "Revenue bonds backed by a special fund, rather than by the government's full faith and credit, are exempt from debt ceilings and referenda requirements because a bondholder's only recourse is against the special fund itself and not against the local government."[152] This doctrine involved reconceptualizing the assessments levied by the district as a form of "self-financing" rather than as a tax in the traditional sense, thereby placing them outside normal legal constraints.[153]

By the end of the Great Depression and during the time of the New Deal Era, "there were over 8,500 special districts across the nation."[154] Much of this sudden proliferation arose due to the efforts of the federal government.[155] Although initially conceived

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Morris, Jr., *Evading Debt Limitations with Public Building Authorities: The Costly Subversion of State Constitutions*, 68 YALE L.J. 234 (1958))).

150. *See id.* ("A 'special fund' is a segregated account within a local government that receives revenue raised from a source separate from the state or local government's general tax revenues, in particular, ad valorem property taxes.").

151. *See id.* (explaining the reasoning of courts that have found special funds to be constitutional (citing GELFAND, *supra* note 6, § 9:11)).

152. *Id.*

153. *See id.* (describing why some courts have found tax increments to be a special source of revenue).

154. Shoked, *supra* note 90, at 1986 (citing WILLIAM ANDERSON, THE UNITS OF GOVERNMENT IN THE UNITED STATES 37 (rev. ed. 1942)).

155. *See id.* at 1986–87

> The Reclamation Act of 1902 authorized large-scale participation by the national government in rural irrigation projects. Within a few years, the Federal Bureau of Reclamation began to push for the amendment of state laws and the passage of national legislation that would encourage the creation of irrigation districts and permit the irrigation districts to enter into contracts with the federal government. A similar pattern developed with respect to the other two prominent districts founded by general laws at the time: housing districts and soil conservation districts. With respect to housing districts, the most important catalyst to their creation and spread was the federal Housing Act of 1937. The Act offered federal subsidies to local initiatives, and New Dealers in Washington made little effort to conceal their preference for dealing with special districts rather

as part of nation-wide irrigation, housing, and conservation initiatives, federal policymakers preferred to work with and channel federal dollars into special taxing districts rather than larger municipalities, which the Roosevelt administration viewed as being "hopelessly indebted and inefficient."[156]

The special district was praised by New Dealers for being "apolitical, specialized, service oriented, and public interest minded," and run by professionals and subject matter experts, rather than subject to the wrangling and corruption of traditional city and county governments.[157]

Special district commentators such as Professors Shoked, Griffith, Galvan, Stahl, Briffault, and Miller all note that courts have been very deferential to legislators in sanctioning the creation of special taxing districts.[158] Even as their uses have slowly shifted over time from single function entities to multi-purpose mini-governments, there has been little effort to reign in their otherwise unfettered powers.[159] In fact, if anything, courts and lawmakers have become increasingly liberal throughout the history of special taxing districts insofar as defining the limits of what they can be created to do and the tools which they can utilize to achieve their goals.[160] They are neither county nor city,

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than cities.

156. *Id.* at 1987 (citing MARTIN J. SCHIESL, THE POLITICS OF EFFICIENCY 46–59 (1977)).

157. *See id.* (noting that the idea of "expertise-driven government" was particularly appealing in the New Deal Era (citing DOROTHY ROSS, THE ORIGINALS OF AMERICAN SOCIAL SCIENCE (1991))).

158. *Id.* For more information on these commentators' views, see Stahl, *supra* note 115; Miller, *supra* note 119; Briffault, *supra* note 85; Shoked, *supra* note 90; Griffith, *supra* note 31; Galvan, *supra* note 114. For additional discussion on the role of special districts in the context of the public financing of private development, see Darien Shanske, *Above All Else Stop Digging: Local Government Law as a (Partial) Cause of (and Solution to) the Current Housing Crisis*, 43 U. MICH. J.L. REFORM 663 (2010); Darien Shanske, *Public Dollars for Private Suburban Development: A First Report on a National Phenomenon*, 26 VA. TAX REV. 709 (2007).

159. *See generally* Shoked, *supra* note 90, at 1990–92.

160. *See id.* (listing the factors that a court will consider in determining special district status (citing Floyd v. Mayor of Balt., 966 A.2d 900, 913 (Md. 2009); Fla. Dep't of Revenue v. Canaveral Port Auth., 642 So. 2d 1097, 1100–01 (Fla. Dist. Ct. App. 1994); RESTATEMENT (SECOND) OF TORTS § 895C cmt. a (1977))).

neither village nor town, yet they are more than a homeowners' association or other private group.[161] Further, they have all of the attributes of a regular corporate body.[162] They can sue, be sued, enter into contracts, and acquire and dispose of property and its various appurtenances.[163] In some cases, the special district even has the power of eminent domain.[164] Special taxing districts possess special features that exempt them from traditional democratic parameters, yet they enjoy the privileges and attributes of private enterprises.[165] And it is through this quasi-public, quasi-private status that they have become both so very enticing and so very dangerous.[166]

3. The Rise of Varied Special District Uses

As the twentieth century marched forward, special districts only continued to rise in popularity.[167] Numerous special purpose taxing districts were created to cover services such as parks, ports, airports, flood control, library maintenance, cemeteries, transportation, emergency services, and an ever-widening array of public infrastructure projects.[168]

One popular and heretofore different form included the business improvement district (BID), which is a special taxing district, the funds from which are used to pay for not only

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161. *Id.* (citing Craig D. Feiser, *Protecting the Public's Right to Know: The Debate over Privatization and Access to Government Information Under State Law*, 27 FLA. ST. U. L. REV. 825, 835–36 (2000)).

162. *See* Callies, *supra* note 27, at 1–3 (describing the legal status of special districts).

163. *See id.* (listing the legal powers of special districts).

164. *See id.* (enumerating the broad powers of special districts).

165. *See* Stahl, *supra* note 115, at 942–44 (explaining how cities have granted special districts a diverse range of powers to operate under).

166. *See id.* at 943–45 (describing one problem with special districts as the fact that they "often cause troubling inequalities between wealthy and poor neighborhoods in the provision of city services"); *see generally* Miller, *supra* note 119; Briffault, *supra* note 85; Shoked, *supra* note 90.

167. *See* Briffault, *supra* note 85, at 503–09 (describing the rise in popularity of special districts).

168. *See* Shoked, *supra* note 90, at 1972–73 (listing various purposes of special districts); *see also* Galvan, *supra* note 114, at 3042 (same).

traditional services such as drainage and sanitation, but also for security patrols and street maintenance and repairs.[169] The first BID is generally believed to have been the New Orleans Downtown Development District, created in 1975, and their popularity increased tremendously in the following decades.[170] In general, "BIDs operate parking facilities [and] maintain public amenities," which include the construction of "streets, sidewalks, fountains, street lights, benches, and other forms of street furniture."[171] One noted such BID is the one around New York City's Times Square area that funds homeless prevention and mitigation efforts.[172] In fact, at one time in the mid-1990s, Grand Central Station infamously used its own BID monies to "drive homeless people" from the area.[173]

The BID was the beginning of the use of special taxing districts as a sort of economic development tool.[174] They were used to help attract and maintain businesses within a certain area—usually downtown—and would often engage in projects that were meant to promote the commercial and business-related activities of those operating within its geographic boundaries.[175] In many ways, BIDs operated like "private chambers of commerce" that used the coercive powers of property taxation to fund their operations, even though they lacked the limitations and mandates of the larger municipal government.[176]

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169. *See* Briffault, *supra* note 85, at 517–19 (listing the non-traditional activities that business improvement districts undertake).

170. Miller, *supra* note 119, at 148.

171. Briffault, *supra* note 85, at 518.

172. *See id.* at 518–19 ("New York's Time Square BID provides services to the homeless" (citing 1 N.Y.C DEP'T OF BUS. SERVS., NEW YORK CITY BUSINESS IMPROVEMENT DISTRICTS 59 (Aug. 1996))).

173. *See id.* at 519 (describing a 1995 controversy in which it was alleged that BIDs were attempting to drive people out of Grand Central and "functioning as a 'goon squad'" (citing Heather MacDonald, *BIDs Really Work*, CITY J., Spring 1996, at 29, 40).

174. *See id.* (linking BIDs to efforts to improve the "business climate within the districts").

175. *See id.* (describing how BIDS used these efforts to "attract and retain business").

176. *See id.* (explaining the tools used by BIDs to attract commerce).

But even the BID played a small part in the rise of the purely private use of special taxing districts compared to those special taxing districts that arose, first in California and then later in Texas and other western states, to fund neighborhood improvements.[177] In California in the 1980s, a referendum was passed called Proposition 13 that put a state-wide cap on all ad valorem property taxes.[178] This greatly hamstrung the ability of local governments to fund critical infrastructure needs throughout the state.[179] In response, the California Legislature passed the Community Facilities Act—commonly known as the Mello-Roose Act—which allowed the creation of special taxing districts, separate and apart from the larger municipality, which would have the ability to impose and increase taxes within neighborhood-sized districts in order to fund infrastructure such as streets, lighting, sewers, and even schools.[180]

Similarly, the Texas constitution was altered in 1971 to authorize the creation of municipal utility districts (MUDs).[181] As with community facility districts in California, these small geographic districts were used to fund infrastructure within certain discrete neighborhoods that would otherwise have been paid for by the municipality.[182] MUDs have been hugely popular in Texas.[183] By one account, there are nearly 1,000 such districts in Texas, and they encompass over 500 acres of land, with the Houston area alone having several hundred.[184]

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177. *See* Galvan, *supra* note 114, at 3042–45 (describing how special districts are used in Texas); Miller, *supra* note 119, at 137–40 (describing how California has used special districts).

178. *See* CAL. GOV'T CODE §§ 53311–53368.3 (Deering 2011) (providing an alternative method of financing public facilities and services); Miller, *supra* note 119, at 148–49 (describing why special districts arose in California).

179. *See* Miller, *supra* note 119, at 148–49 (explaining how Proposition 13 capped property taxes).

180. CAL. GOV'T CODE §§ 53311–53317.5 (2015); *see also* Miller, *supra* note 119, at 148–49 (explaining how Mello-Roos operated). Arizona, Washington, and Hawaii also passed similar acts. *Id.*

181. *See* Galvan, *supra* note 114, at 3044–45 ("The Texas constitution was amended to provide for the establishment of water districts in the early part of the twentieth century.").

182. *See id.* (explaining how MUDs operated in Texas).

183. *See id.* at 3045 ("[A]bout 950 MUDs exist in Texas.").

184. *Id.*

The idea that special taxing districts could be used for purposes other than traditional municipal infrastructure such as bridges, roads, drainage, and the like took hold in a powerful way, and local governments and special district enthusiasts began to imagine a wider array of services and functions being exercised by these unique quasi-public, quasi-private governmental appendages.[185]

B. An Overview of Development Special Districts

The premise that underlies the special taxing district used in connection with private real estate developments (development special districts) rests on the basic notion, as expressed by Professor Stahl, that residents generally desire to control neighborhood externalities.[186] They want to have some level of power over what their neighbors do, how the environment around them is built, and how everyday interactions with outside variables operate.[187]

When individuals began to feel a diminished amount of control and input in the larger municipal governance structure, they looked to a more localized approach as a way to overcome feelings of being looked over or left out.[188] Although all persons within the local government's jurisdiction contributed their share of ad valorem property taxes, the uses to which these funds were put were not always uniform and, some felt, likewise not in their best interest.[189] Homeowners' associations seemed like the answer because they allowed for a form of quasi-government among likeminded individuals.[190] The use of deed restrictions and

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185. *See generally id.*

186. *See* Stahl, *supra* note 115, at 947–49 (explaining why neighborhoods "prize the ability to bring in positive externalities . . . and to keep out negative externalities" (citing ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS (2008); N. GREGORY MANKIW, PRINCIPLES OF MICROECOOMICS 195–213 (2008)).

187. *See id.* (listing the concerns of homeowners and how they interact with their neighbors' actions).

188. *See id.* at 948 (describing why and how homeowners seek power).

189. *See id.* (describing how land use and improvements can affect residential property values).

190. *See id.* at 948–49 (describing why homeowners' associations helped

land covenants ensured that dues were paid and that their collection could be enforced.[191] The funds raised could be used to build improvements such as golf courses, tennis courts, swimming pools, and other neighborhood amenities.[192] The idea that private, localized individuals could and should control their immediate environment, rather than leaving such functions to the larger local government, built the foundation for the proliferation of the development special district.[193]

For most of its history, the special taxing district, when used for infrastructure projects, would cover a large area and everyone within that district would pay assessments in order to receive a particularized benefit. It may have been to obtain sanitary sewer services, water network distribution, or fire and safety services. An important distinction between the use of these districts and those known as development special districts is that the development districts came to include a smaller and more particularized area, often encompassing only a discreet, homogeneous development.

1. Mechanics of Special District Funding

The way in which development special districts work can seem fairly complex, but in fact it is no different than the way all other special taxing districts operate.[194] In general, development special districts use long-term bond financing to fund their projects.[195] The setup involves the district's governing board commissioning a revenue study to determine the borrowing capacity of the district based on its future stream of property tax

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address the issues of neighborhoods).

191. *See id.* at 949 (explaining how homeowners' associations exercised their power).

192. *See id.* (listing the improvements that a homeowners' association could initiate).

193. *See id.* at 951 (explaining how special districts have been crafted to keep control localized).

194. *See* Griffith, *supra* note 31, at 956–61 (describing how special districts are managed).

195. *See id.* at 966–97 (laying out the financing method for infrastructure development districts).

assessment revenues over time.[196] After the bond issuance, an underwriter purchases or markets the bonds to third party investors such as large financial institutions, pensions, or retirement funds.[197] The funds generated from the sale of the bonds are then used by the district to pay for the infrastructure or other special purpose projects.[198] Over time, the collection of the tax assessments on each of the parcels within the district goes toward retiring the debt on the bonds.[199] Thus, the district is able to obtain money immediately through the issuance of these debt instruments, build the improvements immediately, and pay them back over the course of time.[200] Also, the burden of paying for these residential infrastructure projects is shifted from the local government and its general fund to only the owners of the parcels being benefited.[201]

These debt instruments are considered by courts to be revenue bonds, meaning that payment under the bonds is secured by a particular and limited stream of revenue—specifically, the special district's property tax assessments.[202] In other words, no larger governmental general fund or credit worthiness is implicated in the bond issuance.[203] Hence, when special district *X* that lies within county *Y* issues bonds, the repayment of those bonds is secured only by the assessments from district *X*, and county *Y*'s revenue streams are not at all implicated.[204] While investors prefer municipal bonds—which are secured by the more affluent and resource-rich county *Y*—revenue bonds are still very

196. *See* Galvan, *supra* note 114, at 3060 (describing how Texas' districts are funded through tax-exempt bonds).

197. Callies, *supra* note 27, at 1–3.

198. *Id.*

199. *Id.*

200. *Id.*

201. *See id.* ("[T]he arrangements tend to shift the risk of project failure from the local government and its taxpayers to the developers and bondholders.").

202. *Id.*

203. *Id.*

204. *See id.* (describing how risk is segmented).

attractive, as the interest on revenue bonds is exempt from both federal and state taxation.[205]

The deal could not be better for the developer.[206] He gets to use special district financing to construct the infrastructure and improvements as he dictates with no cost to him whatsoever.[207] The district issues the bonds, and the future owners of the land assume the long-term debt obligation.[208] Meanwhile, the profits from the sale of the parcels (as in a residential subdivision) go to the developer.[209]

2. Framework for Special District Lien Enforcement

Payment of the special assessments is enforced by the district's liens on the parcels within the district.[210] In the event that a homeowner fails to pay his special district assessment, his parcel is then encumbered by a lien in favor of the district, which remains on the property until the amount is paid in full.[211] The district can foreclose on a homeowner who fails to pay the assessment—as between creditor (district) and debtor (homeowner), the lien resembles a typical mortgage, lien, or other conventional security device.[212]

But as between this creditor and other creditors, this lien is not like just any conventional security device, subject to the normal rules of recordation, third party rights, and priority.[213]

205. *See id.* (listing factors that an investor may consider prior to making an investment).

206. *See* Galvan, *supra* note 114, at 3048 ("[R]eal estate developments have become [the districts'] most vocal advocates and have received most of their benefits.").

207. *See id.* at 3048–49 (describing the process through which the developers and districts go through the funding process).

208. *Id.*

209. *See* Callies, *supra* note 27, at 1–3 (describing what a corporation has to gain from coordinating with special districts).

210. *Id.*

211. *See* Galvan, *supra* note 114, at 3048 (noting that real estate developers receive the most benefit from these special districts).

212. *See id.* at 3048–51 (listing the powers of special districts).

213. *See id.* at 3048 (explaining the powers and rights that are unique to special district developers and financiers).

Rather, this lien is given the same supremacy over pre-existing liens and property rights as the ad valorem property tax lien.[214]

For instance, a developer may obtain a traditional bank loan in order to purchase real property for his development and, in exchange, grant a mortgage on the property to the bank. Then, in order to construct the infrastructure, he will have a special taxing district created to fund the improvements. The district's board, which he controls, will issue the bonds and raise the funds. The assessments on the parcels within the development will fund the debt service going forward. However, if the developer fails to pay his special assessment on any particular parcel, then a lien will automatically be created on that parcel. And this lien, which arose long after the bank's mortgage, will jump over the bank's rights in the line of ranking and give the district—or more particularly, the bondholders—a first position as to the collateral. Therefore, the special district lien's superpriority status ensures that even conventional liens that arise before the special district lien attaches to the property are nonetheless inferior to the rights of the district.[215]

3. Structuring of Special District Governance

The fact that real estate developers are the major force behind development special district creation is of no surprise.[216] The statutory framework that allows for the creation of these structures is geared toward the developer's benefit—specifically in the way the district's board is governed.[217] The example of how the Texas MUD is created is instructive because it is emblematic of how most all development special districts are crafted.[218] The

214. *See id.* (describing how the rights of these creditors are protected).

215. *See id.* (describing how the rights of certain creditors are protected).

216. *See id.* (noting that real estate developers receive the most benefit from these special districts).

217. *See id.* (describing how MUDs tend to be run by a board of real estate developers).

218. *See id.* at 3048–49 (listing the steps for MUD formation). Professor Galvan gives an extensive and authoritative review of Texas's MUDs and explains how they, in many ways, represent the larger world of special taxing districts nationally. *Id.*

statutory provisions that allow for the creation of MUDs are relaxed at best.[219] There are basically only four steps in the process: "(1) a landowner petition, (2) a review by a state agency, (3) a city or county review, and (4) an election."[220] Because at the beginning of the life of every real estate development the developer owns all the land, only his assent is needed to initiate the petition.[221] The petition is then reviewed by the Texas Commission on Environmental Quality (TCEQ) that analyzes the request in light of "projected construction projects, tax rates, and sewer rates," among other things.[222] Then the petition moves on to the municipal governing body for the jurisdiction where the district will be located for final approval.[223]

As Professor Galvan notes, approval of the petition through these governmental processes often comes as a matter of course.[224] This is true because, from the local government's perspective, there will be no drain on the public purse resulting from the formation of the district—rather, the entity will be, in theory, self-sustaining.[225] And even if the TCEQ and the local government refuse to give their consent to the district's creation, the developer can also ask the legislature to create the district through a special statute, thereby side-stepping this multi-tiered (if only superficial) approval process entirely.[226]

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219. *See id.* at 3049 (explaining how developers are able to take advantage of the lenient legal provisions in forming MUDs).

220. *Id.* at 3049–50.

221. *See id.* at 3050 (listing the steps necessary for MUD approval).

222. *See id.* (describing the four-step process for creating a MUD (citing TEXAS WATER CODE ANN. § 54.021 (Vernon 2002)).

223. *See id.* (explaining that a city's consent is necessary but generally comes as a matter of course (citing Dan Feldstein, *Proposal Raising Home Values—and Tempers*, HOUS. CHRON., July 18, 2006, at A1; Chunhua Zen Zheng, *Pearland Mayor Addresses Growth, Challenges*, HOUS. CHRON. (Brazoria County ed.), Jan. 22, 2004, at 1)).

224. *See id.* ("A city's consent typically comes as a matter of course—even, sometimes, in the face of widespread public disapproval.").

225. *See id.* at 3050–51 (describing why approval rates are so high for MUDs).

226. *See id.* at 3051 (describing how a developer may ask his legislator for assistance in creating an "end run around a reluctant government" (citing Mike Lee & Josh Shaffer, *Developing Power: Regional Growth, Once Dominated by a Few Tycoons, is Now Driven by Agencies, City Managers, Landowners and*

Once the petition is approved, a governing board is appointed by the city council, in accordance with the petition, to operate, to manage, and to make policy decisions on behalf of the special district.[227] But instead of appointing members to the board from various sectors whose interests or expertise would lend credibility and reasoned judgment to the operation of the district, the individuals listed in the landowner's petition are almost always appointed as a matter of course.[228] And naturally, these include the developer's associates, and, in the case of special legislatively-created districts, the developer himself may be a board member.[229]

Because the initial members of the district's governing board are generally handpicked by the developer, they are, with little exception, supportive of his views and intentions with regard to the district.[230] This includes going along with whatever bond issuance details or other financing mechanisms he intends to use to fund the development, as well as the extent and aggressiveness of the build-out of improvements.[231] And even after the district's board is turned over to the third-party owners of the parcels within the development,[232] participation is consistently low.[233]

Average Residents. Though Money Still Talks, Power Is Harder to Hold, FORT WORTH STAR-TELEGRAM, Sept. 1, 2002, at 1)).

227. *See id.* at 3052–53 (discussing the components of special district litigation).

228. *See id.* (explaining the process of appointing individuals to the board).

229. *See id.* (discussing the possibility of working around limitations on board appointments).

230. *See id.* (explaining that often, those appointed to the board are fairly closely connected to the project).

231. *See id.* (discussing the level of control exerted by developers).

232. Typically, after a certain threshold number of parcels with the development have been sold to third parties, the developer will relinquish control of the special district's board to the actual homeowners who will then elect their own representatives. *See generally* Christopher K. Odinet, *The Perils of Primacy: Successor Liability for Lenders Turned Declarants in Louisiana Common Interest Communities*, 74 LA. L. REV. 777 (2014).

233. *See* Galvan, *supra* note 114, at 3053 ("More troubling for a special district than the control of a powerful interest group early in its development is the sustained absence of democratic participation in special district activities over time." (citing JOHN C. BOLLENS, SPECIAL DISTRICT GOVERNMENTS IN THE UNITED STATES 1 (1957))).

One commentator notes that "a turnout of two to five percent is 'unusually high' for special district elections," thereby giving a motivated developer a chance to control the district's administration and processes many years later.[234]

C. Development Special Districts as Economic Development Tools

Over time, it became evident to developers that by partnering with local governments, special districts could be used to promote private real estate projects in new ways.[235] Special taxing districts like MUDs and community development districts provided a perfect framework for these public financing devices.[236] If they could be used to fund traditional neighborhood infrastructure and business development efforts, then why not use them as a source of capital for private development? In that vein, as discussed above, arose the development special district—those special taxing districts that were essentially commandeered by private developers for the purpose of bank-rolling purely private projects—that extended far beyond the traditional roles for which they were initially envisioned.[237] And local governments have been all too eager to embrace the development special district construct.[238] In their view, these types of private real estate financing facilities were perfect—they imposed no obligations on the municipality, and there was no need to either directly fund the critical infrastructure improvements or indirectly guarantee the debt that was incurred in connection

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234. *See id.* (exploring the lack of democratic participation in the development of special districts (citing NANCY BURNS, THE FORMATION OF AMERICAN LOCAL GOVERNMENTS: PRIVATE VALUES IN PUBLIC INSTITUTIONS 12 (1994))).

235. *See id.* at 3043 (introducing the strategy of building private developments through local government units).

236. *See id.* at 3048 (explaining a few ways in which MUDs tax incoming landowners to fund the development of special districts).

237. *See id.* at 3061 (discussing the costs that private developers can recoup because of partnerships with local governments).

238. *See id.* at 3053 (describing a Texas court's ruling that seemed to approve of the link between local governments and private development enterprises).

with their construction.[239] The city was able to outsource the provision of government goods and services to these "quasi-privatized entities [so as to] relieve the city of the need to finance such services."[240]

Further, if the development succeeded, new residents and subsequent property and sales tax revenues would follow.[241] Although the special assessments levied would only go toward benefits enjoyed by those living within the district, the spill-over effect of these new residents on surrounding businesses, entertainment venues, and tourism activities would generate new tax revenues for the municipality as a whole.[242] And how could these special districts not be wildly successful considering the grand projections and attractive renderings presented by the developer when making his request to the city council?[243] After all, many people believed—and particularly so now—that "smaller is better" and that the empowerment of local governments and the "reduction of the scale of decisionmaking" present an optimal scheme of governance.[244] Cities have lauded development special districts as being, aside from self-financing, excellent bubbles in which true civic engagement and democratic idealism play out through better responsiveness, a closer connection to the people, and less bureaucracy.[245]

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239. *See id.* at 3074–75 ("Through annexation of infrastructure-building districts like MUDs, cities can avoid the cost, management, and liabilities of constructing new infrastructure."); *see also* Callies *supra* note 27, at 2 (discussing the consequences of government-assisted private development).

240. *See* Stahl, *supra* note 115, at 984 (suggesting that more judicial oversight is required because cities have an incentive to outsource to private developments).

241. *See* Galvan, *supra* note 114, at 3044 (stating that special districts bring in a lot of revenue).

242. *See* Briffault, *supra* note 85, at 512 (explaining that while much of the revenues raised stay within the development, there is some spillover into the government).

243. *See id.* at 519 (discussing the need to demonstrate that a development will positively impact the area); Galvan, *supra* note 114, at 3050–51 (detailing the steps taken to get a special district development approved).

244. *See* Galvan, *supra* note 114, at 3047 (advocating that more local decision-making is preferable to that on a larger scale (citing Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1057 (1980))).

245. *See id.* at 3048 (providing further support for the idea that smaller

So, according to the prevailing narrative, development special districts are good all around.[246] For the developer, they allow for tax-exempt bond financing at a lower cost than financing available through conventional lenders.[247] And of course, the debt undertaken in connection with building the improvements and infrastructure is off the books of the developer, since the debt is that of the district.[248] The ultimate cost of the improvements need not come, as has traditionally been the case, from the sales proceeds from the lots within the development; rather, the long-term debt service obligations are supported by future owners over time.[249]

Future homeowners are able to avail themselves of amenities and luxuries that the municipality would have never publicly supported or financed.[250] And, because the bonded indebtedness is spread over the long-term assessment of special property taxes on the parcels, the purchase price of the properties need not be inflated to account for the need to repay the debt in the short term by the developer.[251]

And lastly, for the municipality the development special district is an attractive economic development tool.[252] They cost

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governments are preferable to large governments (citing Richard Thompson Ford, *Beyond Borders: A Partial Response to Richard Briffault*, 48 STAN. L. REV. 1173 (1996))); *see generally* Clayton P. Gillette, *Regionalization and Interlocal Bargains*, 76 N.Y.C. L. REV. 190 (2001).

246. *See* Feldman & Rolapp *supra* note 27, at 1–2 (offering advantages and disadvantages to developments).

247. *See id.* at 1 (including financial benefits to the developer in a special district).

248. *See id.* (noting that debts are not incurred by a developer, but by the district).

249. *See id.* (stating that a developer can recoup costs in ways other than just sale price).

250. *See id.* at 2 (offering as an advantage to a future owner the availability of amenities more quickly and at a lower cost than if the property were not in a special district).

251. *See id.* (stating that the sales price is favorable to a buyer because debts are not to be repaid solely from the sale of properties within the special district development).

252. *See* Griffith, *supra* note 31, at 960 (explaining that special districts can provide a means of necessary development in areas that could not afford these improvements otherwise).

nothing to the city, and they have the potential to turn into cash cows for new tax revenues.[253] As discussed above, cities are being called upon to bring about an economic renaissance.[254] With such a call to action, it is all too inevitable that the creation of development special districts will only continue to be embraced by local government decision makers. Local governments are hungry for new tax revenues to support services and necessities that residents demand. However, cities are seeing diminished tax revenues, and there is barely any support from state and federal partners, which was once so free-flowing.[255] The development special district serves as an attractive solution to this problem because it can attract economic investment and grow the tax base.[256]

Economic development investors shop around from locale to locale looking for the right site to land.[257] Investors want to get the best deal possible and maximize their output, productivity, and profitability.[258] This is particularly true of real estate developers.[259] Location is immensely important, but when multiple acceptable sites are identified, concerns turn to how these developments will be financed.[260] Infrastructure costs only continue to rise, and conventional lending can limit the extent of a developer's ability to realize his vision for the project.[261] Lavish

253. *See id.* at 961 (explaining that a major motivation to develop special districts is the ability to make necessary infrastructure updates without necessarily increasing taxes).

254. *See supra* Part II (discussing the current economic climate in cities nationwide).

255. *See generally supra* Part II.

256. *See* Odinet, *supra* note 5, at 220 (introducing the benefits to a successful development, including raised revenues and a larger tax base).

257. *See* Griffith, *supra* note 31, at 975 (discussing the need for local governments to attract developers).

258. *See generally* JOHN P. WIEDEMER, JOSEPH E. GOETERS & J. EDWARD GRAHAM, REAL ESTATE INVESTMENT (2010).

259. *See id.* at 13 (noting that land developers look at the location before making an investment).

260. *See id.* at 1 (introducing the idea that financing real estate development is often an issue).

261. *See id.* 191–94 (providing an overview of cost financing in real estate investment).

chateau-style clubhouses, sweeping golf courses, and crystal-blue swimming pools come at a high cost that can often involve speculative financing. Conventional lenders tend to be risk-averse and are more likely to reign in the whimsical aspirations of the developer.[262]

But the development special district hurdles over all these obstacles.[263] The developer need not borrow any money at all, and no conventional lender need be involved.[264] A well-connected developer with political clout and an attractive-sounding development can easily convince an economic development-hungry city council or county commission to authorize the creation of a special taxing district.[265] And, in fact, the local government may take the offensive itself and affirmatively offer the carrot of a special district to the developer shopping around his project to various locales.[266] While the city cannot promise to actually build the infrastructure from its own general fund, it can certainly create a legal framework whereby the developer can accomplish the same goal through other means—the development special district can do the trick.[267] The tax exemption for interest on municipal and district bonds is key here.[268] Conventional lenders pay tax on the interest they receive, but holders of municipal bonds do not.[269] Therefore, the cost of capital for any developer will be lower to the extent he can bypass conventional lenders and borrow from bondholders who are subsidized by their

262. *See generally* JOHN P. WIEDEMER & KEITH J. BAKER, REAL ESTATE FINANCE (2012); OLIVER R. SIMS & FRANKLIN B. FIELDS, COMMERCIAL REAL ESTATE LENDING: RISK MITIGATION AND BANK SUPERVISION (2013).

263. *See supra* Part III.B (noting that special district developments have thrived).

264. *See generally supra* Part III.B.

265. *See generally supra* Part III.B.

266. *See supra* Part II (noting that local governments benefit from special districts because they finance infrastructure development that the local government often cannot fund on its own).

267. *See supra* Parts II–III (explaining the process involved in developing a special district).

268. *See* Griffith, *supra* note 31, at 939 (discussing methods of financing special district development).

269. *See id.* at 970 (explaining the interest exemption for municipal bonds).

income-tax deduction.[270] Development special districts were widely used prior to the Great Recession.[271] Many developments, ranging from the Deep South to the West Coast and up the eastern seaboard, utilized these quasi-public, quasi-private entities to achieve the goals of real estate developers without hamstringing the public purse.[272] But in the age of cities where the prevailing view is that local governments pose the best chance for economic recovery, the drive to use a variety of public tools and incentives has the potential to result in the creation of many more development special districts under the mantle of economic development.[273] After all, the city will inevitably reap the manifold economic benefits that result from the successes of developments like Beau Chateaux.[274] Development special districts serve as a great low-cost financing tool for the developer.[275] The infrastructure and improvement expenses of the project, although derived from a form of property taxation, cost the city nothing at all.[276] Or do they?

IV. Understanding the Unintended Consequences

Despite all the accolades surrounding development special districts and their ability to have a positive effect on the local

270. *See* Galvan, *supra* note 114, at 3060 (discussing how developers can lower costs by financing with municipal bonds).

271. *See* Shoked, *supra* note 90, at 1986 (discussing the widespread use of special districts).

272. *See* Galvan, *supra* note 114, at 3044 (discussing MUDs in Texas); Griffith, *supra* note 31, at 960–74 (discussing Florida's community development districts, Georgia's infrastructure development districts, Colorado's public improvement districts, Delaware's special development districts, and New Mexico's public improvement districts); Miller, *supra* note 119, at 148–49 (discussing public facilities districts in California).

273. *See* Shoked, *supra* note 90, at 2000 (discussing the benefits of developing special districts).

274. *See* Griffith, *supra* note 31, at 961 (explaining that cities are motivated to develop special districts).

275. *See* Galvan, *supra* note 114, at 3061 (discussing the low costs for private developers of special districts).

276. *See supra* Part III.B (explaining the benefits to financing infrastructures by developing special districts).

economy, little attention has been paid to some of the harsh, unjust, and far-reaching negative consequences that result from their use in terms of mortgage rights, real estate lending, and market equity.[277] While true that they do not cost the city anything directly and that, if successful, they have the potential to increase tax revenues, other considerations that underlie their creation are often ignored.[278] And with local government leaders continuing to use development special districts to achieve their economic development goals, these negative consequences are even more likely to be ignored.[279]

A. Undermining Vested Property Rights

The first negative consequence brought about by development special districts has to do with the way in which the corporation is able to enforce the payment of its special property tax assessments.[280] As discussed above, if an individual parcel owner refuses or fails to timely pay his assessment, the district is automatically granted a statutory lien against that property in proportion to the amount of the assessment,[281] which the district can then foreclose upon.

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277. *See* Galvan, *supra* note 114, at 3068 (introducing some negative consequences to the increased development of special districts); Griffith, *supra* note 31, at 972 (discussing the consequences of using special districts); Miller, *supra* note 119, at 153 (discussing racial and ethnic segregation as negative consequences of special districting); Shoked, *supra* note 90, at 2002 (introducing some costs of developing through special districts).

278. *See* Galvan, *supra* note 114, at 3053 (discussing the lack of democratic participation involved with special district development).

279. *See* Ritchie, *supra* note 22 (discussing the impacts of the financing of a special district development, which left residents with a great deal of bond debt); Watson, *supra* note 102, at 220 (introducing the notion of competitive local governments, which might motivate cities to use special districting to effect development); White, *supra* note 8 (providing examples of failed special taxing districts).

280. *See generally* Callies, *supra* note 27.

281. *See id.* at 786 ("To those owners who refuse to pay, the association can place a property lien against their parcel and thereby cause issues of non-merchantable title, violations of existing loan agreements, and a weakening of the parcel's commercial viability.").

1. Special District Liens Compared to Common Interest Community Liens

At first blush, this is no different than the statutory liens that are accorded to homeowners' associations, condominium associations, and every other type of common interest ownership regime across the country when an owner fails to pay his association dues.[282] The ability to impose a lien on the property serves as one of the coercive functions that allow common interest ownership communities to control externalities.[283] Without the ability to punish noncompliant homeowners, the neighborhood association would be without the ability to create positive externalities and to ward off negative ones.[284] The entire common-interest-community scheme would be rendered merely voluntary and, therefore, lose much of its allure and effectiveness.[285] Furthermore, many homeowners' association statutes, condominium association statutes, and similar legal frameworks limit the extent to which the association can impose dues.[286] This, in turn, helps keep the enforcement mechanism in

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282. *See* EVAN MCKENZIE, PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT 140 (1994) (comparing homeowners' associations to private governments); Gregory S. Alexander, *Dilemmas of Group Autonomy: Residential Associations and Community*, 75 CORNELL L. REV. 1, 23 (1989) (discussing traditional payment mechanisms in place in residential communities); Frank Michelman, *Universal Resident Suffrage: A Liberal Defense*, 130 U. PA. L. REV. 1581, 1582 (1982) (introducing the power structure in place in most resident communities).

283. *See* Wayne S. Hyatt, *Common Interest Communities: Evolution and Reinvention*, 31 J. MARSHALL L. REV. 303, 305 (1998) (introducing the "social infrastructure" found in community developments); Stahl, *supra* note 115, at 947 (discussing the ability to control externalities within neighborhoods).

284. *See* Shirley L. Mays, *Privatization of Municipal Services: A Contagion in the Body Politic*, 34 DUQ. L. REV. 41, 57 (1995) (discussing the mechanism through which these neighborhoods can exert control over residents); Stahl, *supra* note 115, at 977 (explaining why residents have an interest in controlling the properties within the development).

285. *See* Susan F. French, *Making Common Interest Communities Work: The Next Step*, 37 URB. LAW. 359, 362 (2005) (exploring differences between neighborhoods with voluntary and with mandatory membership).

286. *See* SETHA LOW, BEHIND THE GATES: LIFE, SECURITY, AND THE PURSUIT OF HAPPINESS IN FORTRESS AMERICA 173–95 (2003) (providing an insider account of life in gated communities); Todd Brower, *Communities Within the Community: Consent, Constitutionalism, and Other Failures of Legal Theory in Residential*

check so as to ensure that individual financial obligations do not become overly burdensome.[287]

However, what makes the development special district different is that it is a public body and the law gives the liens that are imposed in connection with its assessments superpriority (the same status as ad valorem property tax liens).[288] Property tax liens enjoy superpriority such that they generally prime all pre-existing liens on the property.[289] General common interest community liens do not enjoy the superpriority.[290] Although some states allow for HOA liens to be given some form of preferred priority, it is always only for a certain limited period of time and only for a certain amount—typically fairly nominal compared to the unbounded amounts that be imposed through the special district lien.[291]

2. The Superpriority of Ad Valorem Property Tax Liens

The fact that general ad valorem property tax liens are given superpriority status is not unusual.[292] In fact, this has long been the rule because the government has a substantial interest in ensuring the timely and efficient collection of property taxes.[293]

Associations, 7 J. LAND USE & ENVTL. L. 203, 229 (1992) (discussing statutory limitations on homeowners' associations).

287. *See generally* LOW, *supra* note 286 (discussing real-life accounts of residents in gated communities).

288. *See* Callies, *supra* note 27, at 2 (discussing the consequences of government-assisted private development).

289. *See id.* (discussing the financial consequences of private developments aided by public government).

290. *See* Paula Franzese, *Privatization and Its Discontents: Common-Interest Communities and the Rise of Government for "the Nice*,*"* 37 URB. LAW. 335, 348 (2005) (discussing the stringent payment requirements in place in some housing communities); French, *supra* note 285, at 363 (discussing similarities between communities associations, cities, and corporations).

291. *See* Miller, *supra* note 119, at 131 (noting the use of HOAs in California); Stahl, *supra* note 115, at 990 (discussing the impact of liens on property owners).

292. *See* Shu-Yi Oei, *The Uneasy Case for Tax Lien Subordination*, 11 PITT. TAX REV. 241, 248–56 (2014) (introducing the current tax lien priority scheme).

293. *See* Thomas Bonura, *Misdirected Hostility: Are Criticisms of Texas Property Tax Lenders Justified?*, 53 S. TEX. L. REV. 569, 570 (2012) ("With the

Revenues from these taxes go toward supporting an array of important public necessities—everything from roads and bridges to schools and hospitals.[294] So, although granting the general property tax lien a priority over pre-existing liens is an exception to the law's usual first-in-time priority rule, the exception is justified because of the compelling societal benefit that is achieved by giving them the first position.[295]

Because the residents of the municipality rely upon the general collection of property taxes in order to fund services and public goods that are needed by the entire populace, it is reasonable, and in fact necessary, that the liens that arise in connection with their enforcement are given special treatment.[296] And the market has easily accommodated this framework.[297] When individuals take out a residential loan secured by a mortgage, the bank builds into the monthly payments an amount sufficient to take care of the annual property tax bill because the lender anticipates that the property tax lien will, by law, prime the mortgage.[298]

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growing demand for these lien purchases and the growing desire of local governing entities to develop and facilitate an industry that maximizes revenue collection, it is no surprise that the volumes of tax lien transactions have risen at a corresponding rate.").

294. *See generally* GLENN W. FISHER, THE WORST TAX?: A HISTORY OF THE PROPERTY TAX IN AMERICA (1996).

295. *See id.* at 7 (noting that property taxes are justified by the benefits resulting from the revenues raised); Frank Alexander, *Tax Liens, Tax Sales, and Due Process*, 75 IND. L.J. 747, 802 (2000) (discussing the increase in revenue that can result from certain tax liens).

296. *See* Alexander, *supra* note 295, at 806 (noting the special nature of enforcing payment of property taxes).

297. *See id.* (discussing the shift that has occurred to accommodate a need for changing property tax enforcement).

298. *See generally* Richard J. Andreano, Jr., Stanley D. Mabbitt, John D. Socknat & Michael S. Waldron, *CFPB Adopts Mortgage Escrow Account Final Rule*, 67 CONSUMER FIN. L.Q. REP. 53 (2013).

3. The Deprivation of Property Rights Without Just Compensation

However, the liens that arise in connection with development special districts are quite different.[299] The developer, who initially owns all the land in the development, has the ability to indirectly appoint his people to the district board and thus is the one who, practically speaking, controls the amount of assessments that will be charged against each of the lots.[300] Therefore, he has control over not only the amount of the liens but also over their enforcement, including in preference to his real estate lender.[301]

Going back to the example in the introduction above, the developer initially obtained a loan from Realty Bank so he could purchase the land and have some capital for the initial build out. The bank had its mortgage recorded as a first lien on the property. Then, a few months later, the developer had the local government grant him a special taxing district as part of their incentive package to entice him to come and develop in the area. The petition and the governing documents for the district were drawn up by the developer's attorneys. Once approved, the developer swiftly had the board appointed composed of all his friends and supporters and began the process of having his attorneys and financial advisors generate the bond documents.

Spurred on by local government politicians eager for his success and buttressed by his own visions of the ultimate real estate community, the developer had the board issue a massive bond issuance to pay for the many luxuries and improvements he intends for Beau Chateaux. Realty Bank monitors these events in horror, understanding that the liens (which will be substantial) arising from this bond issuance will prime their pre-existing mortgage, but the bank is unable to do anything to stop it. As long as the developer is timely in making the debt service on Realty Bank's loan, there is nothing to legally be done.

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299. *See* Callies, *supra* note 27, at 1 (introducing the distinct nature of financing special districts).

300. *See* Galvan, *supra* note 114, at 3051–54 (discussing developer control over special districts, especially in the early stages).

301. *See id.* at 3049 (noting the ability of most developers to choose a financial institution).

But when Beau Chateaux fails and the district goes into default on its bonds because of a massive failure to pay the special assessments, the bondholders move to force the district to foreclose on its liens and have the properties seized and sold.[302] At the same time, the developer defaults on his loan to Realty Bank. Realty Bank now moves to exercise its mortgage rights to foreclosure on the property and to have it seized and sold.[303] Technically Realty Bank's mortgage was given first position due to the normal recording acts system. However, because the special district's liens are given the same priority as general ad valorem property tax liens, the Beau Chateaux district's right will enjoy superpriority. Realty Bank's interest will be subordinated, regardless of the fact that its rights arose first and that without its initial capital, the development would not have even been possible.[304]

Importantly, the subordination of Realty Bank's lien represents the taking of a private property interest by the government.[305] However, as discussed above, no just compensation is due because of the theory that property tax liens serve a broader societal good.[306] But is that really true? The general property tax lien surely serves such a purpose.[307] Everyone within the jurisdiction enjoys the benefits conferred by general-purpose property taxes—they can all use the schools, the sewer system, the fire and policy services, and the water distribution networks.[308] But this is not the case with the

302. *See* White, *supra* note 8 (discussing a decline in quality of life in an abandoned special district development).

303. *See generally* Ritchie, *supra* note 22.

304. *See* Bonura, *supra* note 293, at 579 (noting that the interests of creditors may be subordinated).

305. *See* Alexander, *supra* note 282, at 792 (framing the issue of subordination as a possible taking).

306. *See id.* at 748 (introducing the nature of the property tax); FISHER, *supra* note 294, at 6 (noting that people would resist paying taxes more strenuously if they did not receive some benefit from the revenues).

307. *See* FISHER, *supra* note 294, at 6 (discussing how support for a property tax is traced to the idea that the people are benefitted in some way).

308. *See id.* at 187–205 (discussing the current property tax regime and the way in which revenues are spent).

development special district.[309] The benefits conferred by these property taxes are not widespread or shared in the least.[310] Rather, the goods and services that arise from these assessments are solely enjoyed by a discrete group of individuals in a purely private development.[311]

It is a foundation of constitutional jurisprudence that one cannot be deprived of one's property interest without being accorded just compensation in relation to the value of what was taken.[312] When the government exercises its power of eminent domain to take one's land for a public park or to obtain an easement for utilities or a right of way for a road, the private landowner is compensated.[313] Those who possess security rights in property, such as the mortgage lien given to Realty Bank, also have vested property rights that are given constitutional protections.[314] The only reason the ad valorem property tax lien's superpriority does not require just compensation is because of the very broad and compelling government interest that is served by giving it such a status.[315]

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309. *See* Miller, *supra* note 119, at 155–57 (discussing the fact that often the benefits provided by a special district are limited to that specific neighborhood).

310. *See* Griffith, *supra* note 31, at 974 (noting that the benefits affect a limited number of area residents).

311. *See id.* at 962 (discussing how special districts are created to accommodate small groups of residents who want the same services).

312. *See* U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation."); Kelo v. City of New London, 545 U.S. 469, 477 (2005) (explaining what results when a government takes property without compensating the owner).

313. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1106 (1972) (discussing eminent domain); Carol M. Rose, *The Shadow of The Cathedral*, 106 YALE L.J. 2175, 2181 (1997) (discussing the state's option to use private land for public purposes).

314. *See* Priya S. Gupta, *The American Dream, Deferred: Contextualizing Property After the Foreclosure Crisis*, 73 MD. L. REV. 523, 556 (2014) (noting that banks often hold security interests in people's homes); Michael S. Moskowitz, *Treading Water: Can Municipal Efforts to Condemn Underwater Mortgages Prevail?*, 41 PEPP. L. REV. 633, 647 (2014) (protecting security rights).

315. *See* Alexander, *supra* note 295, at 770–71 (discussing the superpriority status of property tax liens).

But this rationale is entirely absent from the super status given to development special liens.[316] They serve only to enrich a very narrow, limited, and private interest—namely, to fund the services and amenities of a private real estate development.[317] It makes no sense to effectively render the rights of third parties like Realty Bank valueless in the name of paying for a golf course, a community pool, and other private luxuries for Claire, Henry, and their fellow residents in Beau Chateaux. However, that is exactly what the development special district lien allows.[318]

B. Destabilizing Conventional Real Estate Lending

Another unintended consequence that results from the spread of development special districts has to do with their impact on the conventional lending market.[319] The way in which special districts fund their improvements and operations serves in many ways as a sort of private bank for the developer.[320] He gets free capital at low costs from a source that he practically controls.[321] In exchange, he need not sign any personal guarantees or promissory notes, and if the project fails, the obligations are non-recourse to him.[322]

It may seem that this scenario operates independently of other facts and that the unjustness of this situation is more policy-oriented. If a given municipality chooses to bestow such benefits on a developer, then why should it not be free to do so?

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316. *See* Callies, *supra* note 27, at 2 (discussing the reasons for prioritizing property tax liens).

317. *See* Stahl, *supra* note 115, at 941 (introducing the idea that only a small group benefits from the liens in special districts).

318. *See id.* at 990 (discussing the practical effect of a lien).

319. *See* Saft, *supra* note 32 (providing an overview of financial transactions).

320. *See* Briffault, *supra* note 85, at 514 (discussing the initial funding for special district development).

321. *See id.* at 522 (explaining one way that developers see their projects financed).

322. *See* Galvan, *supra* note 114, at 3048 (noting that the development projects are low or no cost to the developer).

However, as discussed above, other creditors with vested property interests in the form of liens are subordinated to the special district's interest.[323] And this subordination, as discussed below, has a serious impact on the conventional real estate lending market as a whole.[324]

1. Impact on the Primary Mortgage Market—Community Lending Impacts

In the traditional scenario, lenders assess their risk and make a determination on how much and under what conditions they will lend for a real estate project based on the economic and financial projections of the undertaking, the creditworthiness of the borrower, and the value of available collateral to secure the repayment obligation.[325] The lender will advance funds if and only if it believes sufficient property has been posted as security for the loan.[326]

In the event that the borrower, despite reasonable revenue projections and a clean credit history, defaults under the loan, the lender can foreclose upon the collateral, have it seized and sold in accordance with law, and apply the proceeds from the sale to the remainder of the debt.[327] However, the value of the security in the collateral is premised on the idea that the lender has a first position lien on the property.[328] If another creditor has a superior position, then the property will be seized and sold and the proceeds applied in preference to the higher ranked creditor

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323. *See* Callies, *supra* note 27, at 2 (discussing the priority given to certain property tax liens); Larson, *supra* note 40, at 605 (noting that private lenders' interests are subordinated to municipal lenders).

324. *See* Cox, *supra* note 23, at 104 (discussing the impact of subordination on home financing).

325. *See* Saft, *supra* note 32 (providing an overview of the lending process).

326. *See generally* GRANT S. NELSON ET AL., REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT: CASES AND MATERIALS (8th ed. 2009).

327. *See id.* at 49 (offering a scenario in which a lender might advance funds).

328. *See id.* at 94 (discussing the impact of priority position on lenders' perception).

before the lender is repaid.[329] And, if the foreclosure sale does not draw a high enough bid (as is often the case), then the inferior-positioned lender may end up with nothing at all.[330]

Because real estate lenders cannot know at the time of making the loan whether a development special district will be created and thereby prime their security rights, lenders will eventually begin tightening credit in real estate development lending generally.[331] This is particularly true with regard to the use of development special districts for purposes that truly are for a broader societal benefit.[332] For instance, some municipalities have not completely handed over the development special district device to private developers; rather, some have used them to partner with private developers to build in areas where conventional financing is not available.[333] Such blighted and economically depressed areas are unable to attract private investment at the level that would be needed to truly improve

329. *See generally* SIMS & FIELDS, *supra* note 262.

330. *See id.* at 555 (giving a hypothetical example of a foreclosure sale).

331. For more information on this topic, see generally Larson, *supra* note 40 and the accompanying discussion of the PACE issue's effect on real estate lending.

332. *See, e.g.*, *Acquisition for Spot Blight Removal*, HUD, http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/communitydevelopment/rulesandregs/memoranda/acqspot89 (last visited Mar. 30, 2015) (discussing the national effort to improve neighborhoods) (on file with the Washington and Lee Law Review)

333. *See, e.g.*, Keila Szpaller, *Missoula Aggressively Uses Urban Renewal Districts*, MISSOULIAN (June 26, 2014, 6:30 AM), http://missoulian.com/news/local/missoula-aggressively-uses-urban-renewal-districts-councilman-stresses-blight-not/article_e80f4ae2-8629-11e3-88ec-0019bb2963f4.html (last visited Mar. 30, 2015) (discussing the use of urban renewal districts to improve neighborhoods in Missoula, Montana) (on file with the Washington and Lee Law Review); Bill Varian, *Hillsborough Looks at Focusing Taxes to Fight Blight*, TAMPA BAY TIMES (Mar. 10, 2013, 5:30 AM), http://www.tampabay.com/news/localgovernment/hillsborough-looks-at-focusing-taxes-to-fight-blight/210 8177 (last updated Mar. 11, 2013, 12:55 AM) (last visited Mar. 30, 2015) (looking at new taxes to address blight in Florida) (on file with the Washington and Lee Law Review); Sarah Westwood, *Blight, Be Gone: BoC Plans to Form Authority to Tackle Issues in South Cobb*, MARIETTA DAILY J. (June 15, 2014, 4:00 AM), http://www.mdjonline.com/view/full_story/25293725/article-Blight--be-gone--BoC-plans-to-form-authority-to-tackle-issues-in-south-Cobb (last visited Mar. 30, 2015) (discussing plans to address blight in Georgia) (on file with the Washington and Lee Law Review).

that community.[334] However, the city—through the granting of a development special district—a willing affordable housing developer, and a community-minded bank might be able to partner and bridge the financing gap to reinvigorate whole neighborhoods that have traditionally been cut off from the financing market.[335]

But as development special districts continue to serve as piggy banks for private developers to construct lavish subdivisions such as the likes of Beau Chateaux, conventional lenders—however community-minded they may be—will be hesitant to lend in any project that might involve a development special district.[336] In other words, the use of development special districts in such an aggressive and unrestrained way by purely private developers dirties the water for the use of these special districts for truly altruistic and worthy purposes.[337] Banks and other lenders will shy away from advancing the "first-in" capital or the bridge financing because of the fear that the special district bond issuance will not be closely regulated or limited in scope in accordance with a conservative and realistic projection of the performance of the project.[338]

2. Impact on the Secondary Mortgage Market—Comparison to PACE

The impact of development special districts is not only relevant to the primary mortgage market where loans are

334. *See* Varian, *supra* note 333 (explaining plans in place that aim to attract private investors to the region); Westwood, *supra* note 333 (discussing the impact of "years of neglect" and the plans for future improvements).

335. *See* Szpaller, *supra* note 333 (explaining plans to use special districts to finance improvements to the region).

336. *See* Galvan, *supra* note 114, at 3048 (describing the mechanics of financing a special district development). *See generally* Callies, *supra* note 27 (discussing the unique financing of special districts).

337. *See* Griffith, *supra* note 31, at 963 (discussing the use of special districts to control where revenues are spent).

338. *See* Larson, *supra* note 40, at 620 (discussing the fear of lenders that borrowers will exceed their own ability to pay).

initially made.[339] Rather, the potential to have a significant impact on the secondary mortgage market is where development special districts can cause the real injury. Many property lawyers, policymakers, and sustainability advocates will remember the issues surrounding the Property Assessed Clean Energy (PACE) program.

PACE was initially known as the "Berkeley First Program" where a local business called Renewable Funding created a structure for financing residential solar energy systems and other energy efficiency improvements by partnering with local governments.[340] The expenses related to these improvements for individual homes were built into the homeowner's annual property tax bill.[341] The idea came from a dilemma whereby homeowners would spend many thousands of dollars installing energy efficient improvements in their homes, but would not necessarily see the cost of these improvements translate into an increase in their home's value.[342] Homeowners never totally recouped their losses upon the sale of the homes.[343] And even when homeowners were able to get bank financing for these improvements, individuals rarely wanted to borrow the money due to their being compelled to continue making loan payments even after the property had been sold to a new owner.[344] To address these issues, PACE was born.[345]

PACE relies upon special property tax assessments to finance the energy improvements on the properties within the

339. *See id.* at 620 (explaining which financing tools are most in demand in mortgage markets).

340. *See Berkley First*, OFF. ENERGY & SUSTAINABLE DEV. FOR CITY OF BERKLEY, http://www.ci.berkeley.ca.us/ContentDisplay.aspx?id=26580 (last visited Mar. 30, 2015) (describing a financing program in the City of Berkley) (on file with the Washington and Lee Law Review).

341. *Id.*

342. *See* Cox, *supra* note 23, at 104 (noting that improvements do not always increase a home's value).

343. *See About PACE*, PACENOW.ORG, http://pacenow.org/blog/about-pace (last visited Mar. 30, 2015) (describing the PACE program as an effective financing tool that saves homeowners money) (on file with the Washington and Lee Law Review).

344. *See id.* (discussing the benefits of PACE financing).

345. *See id.* (describing the challenge that PACE seeks to solve).

PACE district.[346] The setup sounds familiar. Generally, the municipality would create a special taxing district for a certain area of the locality.[347] Bonds would then be issued and would be repaid by the future special property tax assessments over time.[348] As with development special districts discussed above, the lengthy term for repayment (usually twenty years) allowed individuals to enjoy the energy savings from the improvements, but only required participants to pay a nominal amount each year.[349] Municipalities loved it too because the increased efficiency of utilities was good for the pocketbooks of the general populace,[350] and the need for more sustainable providers and software technicians created economic overflow and, thus, more tax revenue.[351] The plan sounded perfect.

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346. *See* Joel B. Eisen, *Can Urban Solar Become a "Disruptive Technology?": The Case for Solar Utilities*, 24 NOTRE DAME J.L. ETHICS & PUB. POL'Y 53, 84 (2010) ("Project funding comes from special tax bonds repaid through taxes collected on the property tax bills of participating owners. California pioneered this approach, and as of 2010, eighteen states had laws that allow their counties and cities to establish special assessment districts for energy financing.").

347. *See* HANNAH MULLER & SARAH TRUITT, U.S. DEP'T OF ENERGY, SOLAR POWERING YOUR COMMUNITY: A GUIDE FOR LOCAL GOVERNMENTS 35 (July 2009) (discussing the way special districts are set up to finance clean energy); Annie Carmichael, *Property Assessed Clean Energy (PACE) Enabling Legislation*, VOTE SOLAR (Mar. 18, 2010), http://www.pacenow.org/wp-content/uploads/2012/07/PACE_enablinglegislation-3.18.10.pdf (explaining that local governments set up special districts to finance clean energy).

348. *See* Erin Elizabeth Burg Hupp, *Refining Green Building Regulations and Funding Green Buildings in Order to Achieve Greenhouse Gas Reductions*, 42 URB. LAW. 639, 645–46 (2010) ("These costs are repaid to the city over twenty years through a special tax on the property.").

349. *See* JASON COUGHLIN, NAT'L RENEWABLE ENERGY LABORATORY, PHOTOVOLTAICS (PV) AS AN ELIGIBLE MEASURE IN RESIDENTIAL PACE PROGRAMS: BENEFITS AND CHALLENGES 2 (June 2010) (discussing the financial benefits to homeowners who opt into programs such as PACE).

350. *See* Kate Galbraith, *Can a National Energy-Efficiency Program Work in Texas?*, TEX. TRIB. (July 19, 2010), http://www.texastribune.org/2010/07/19/can-a-national-energy-efficiency-program-work-in-t/ (last visited Mar. 30, 2015) (providing an overview of arguments for and against participation in PACE programs) (on file with the Washington and Lee Law Review).

351. *See* Eric Jamison, *Property Assessed Clean Energy—A Bright Spot in Michigan's Economic and Environmental Future*, GREAT LAKES LAW (Sept. 10, 2009), http://www.greatlakeslaw.org/blog/2009/09/property-assessed-clean-energy--a-bright-spot-in-michigans-economic-and-environmental-future.html (last visited Mar. 30, 2015) (discussing the enactment of PACE legislation in

But alas, it was not to be. The PACE special district liens were also given superpriority on par with ad valorem real property taxes, as is accorded to all special taxing district liens, including development special districts.[352] Thus, homeowners who utilized the PACE program to finance their infrastructure enabled a lien to attach to their property to secure repayment of the bonds.[353] This lien, as with development special districts, had the effect of priming the pre-existing lien rights of the homeowner's mortgage lender.[354] As a response, in July of 2010, the Federal Housing Finance Agency (FHFA) stated that Fannie Mae and Freddie Mac would stop purchasing mortgages on the secondary market if the collateral was within a PACE district, even if the homeowner was not a participant in the program.[355] The result of this action was to effectively kill all PACE activity across the U.S.[356] For fear of having a negative impact on residential financing within their municipalities, local governments stopped creating PACE districts altogether.[357] And, as might be imagined, lenders who could not count on selling

Michigan) (on file with the Washington and Lee Law Review).

352. *See* Larson, *supra* note 40, at 609 ("Any such assessment constitutes a lien on the property and is collected 'in the same manner and with the same priority as ad valorem real property taxes.'" (citing MO. REV. STAT. § 67.2815.5 (2010))).

353. *See id.* at 600 ("Under such a program, the cost of qualified energy improvements is added as an assessment tax to the owner's yearly property tax bill, with the obligation to pay being secured by a lien on the encumbered property.").

354. *See id.* at 610–13 (discussing the concerns of major mortgage lenders about the lien prioritization of PACE liens).

355. Bulletin from Freddie Mac to Freddie Mac Sellers and Servicers 1 (Aug. 31, 2010), http://www.freddiemac.com/singlefamily/guide/bulletins/pdf/bll1020.pdf (discussing changes to the mortgaging policy regarding homes within PACE districts).

356. *See* Todd Woody, *Homeowners Must Pay Off Energy Improvement Loans*, N.Y. TIMES (Aug. 31, 2010), http://green.blogs.nytimes.com/2010/08/31/homeowners-must-pay-off-energy-improvement-loans/?_r=0 (last visited Mar. 30, 2015) (discussing the halt of the PACE program as a result of an unresolved dispute with major mortgage lenders) (on file with the Washington and Lee Law Review).

357. *See* Wilson et al., *supra* note 39, at 281–88 (discussing the goal of PACE programs and the debate surrounding them).

their mortgage loans on the secondary market had no interest in making residential loans in PACE district-related areas.[358]

PACE special districts have exactly the same rights and powers as development special districts.[359] And, in fact, the development special districts pose a much greater threat because they are allowed to finance a wide array of improvements far beyond solar panels, rain retention basins, and the like.[360] As a result, their bond issuances can be much larger and can produce a far more substantial lien than what would normally be spawned by a PACE district.[361]

As local governments continue to embrace development special districts in their efforts to meet the growing expectation that they lead the way in terms of economic recovery, it is inevitable that eventually the secondary market as a whole—particularly the government-sponsored entities—will step in and put a stop to the use of development special districts altogether in the same fashion as was done with PACE.[362] And this too produces a societal ill because it further erodes the legitimate use of development special districts in connection with bettering truly deserving projects in economically depressed areas.[363]

C. Clothing Private Interests with Public Powers

Last but not least, the development special district give-away has a substantial negative effect on fundamental market fairness.[364] Vying for economic development projects is

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358. *See id.* at 39–40 (discussing the impact of the PACE program on mortgage lenders).

359. *See generally* Wrapp, *supra* note 24 (discussing the various ways different districts can be used to finance projects).

360. *See* Callies, *supra* note 27, at 326 (noting the amenities financed through private district developments); Wilson et al., *supra* note 39, at 276–78 (discussing the various uses for PACE funding).

361. *See* Larson, *supra* note 40 at 601–03 (explaining the mechanics of a PACE lien).

362. *See id.* at 612 (discussing the way the PACE program was essentially brought to a halt).

363. *See id.* at 618 (noting the community benefits of the PACE program).

364. *See* Odinet, *supra* note 232, at 825–32 (critiquing the current system for

undoubtedly a part of municipal competition.[365] This has been so prior to the Great Recession and continues to be so even more today.[366] As a part of this process, cities and local governments package together various incentive plans—sometimes tax breaks, sometimes direct grants, and even sometimes special taxing districts—all in an effort to lure in the ultimate prize.[367] Presenting the best carrot in terms of the investors or businesses getting the biggest bang for their buck is how economic development battles between municipalities are ultimately won.[368]

1. The Profits and Problems of Public-Private Partnerships

The coupling of a development special district with the efforts and capital of a private real estate developer are often described as a form of public–private partnership.[369] Under this scheme, the city subsidizes private development in the hopes of a public return.[370] Such arrangements have long occurred and have

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its unfairness).

365. *See id.* at 793 (discussing the effect of competition on the finance market).

366. *See* Watson, *supra* note 102, at 220 ("As the economy begins to rebound from the Great Recession, competition between cities has become palpable in recent years."); Casella, *supra* note 54 (discussing the trend of development outside of major cities); Parisella, *supra* note 54 (discussing the importance of major cities).

367. *See* Watson, *supra* note 102, at 7 ("[L]ocal governments enter the market as sellers competing against other localities for development. . . . The local government is selling its quality of life, its location, its available sites, its workforce, and various incentives in the same way that a private company sells its products to consumers.").

368. *See* Odinet *supra* note 5, at 220 ("Cities often compete with one another to lure this economic development projects by each offering their own package of public incentives for the private business or developer to consider.").

369. *See* Callies, *supra* note 27, at 21 ("Virtually every state authorizes tax increment financing in some form, almost exclusively for redevelopment projects.").

370. *See id.* at 20 ("Tax increment financing . . . is 'free money' used to pay for the redevelopment and then returned to its rightful place as part of a now-enhanced stream of revenue to the governmental bodies which levy such taxes on the property in the first place.").

often carried a heavy price tag. In 2004, the City of New York meted out $100 million in public incentives to prevent Goldman Sachs from moving its headquarters to neighboring New Jersey.[371] And after the 2008 financial crisis, New York City, eager to keep its venture capital population firmly in place, handed out $45 million in seed money to private sector projects.[372]

But these public–private partnerships, despite being widely lauded even by the likes of President Obama, rarely turn out as rosy as they are initially envisioned.[373] They necessarily involve giving preference to one private entity over another.[374] Instead of forcing the private party to weather the risk associated with its for-profit ventures, and thereby having skin in the game to temper its expectations, the public subsidy largely frees them from such considerations.[375] With the development special

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371. *See* Odinet, *supra* note 5, at 236 ("For instance, in 2004 the city of New York allocated $100 million worth of public incentives to Goldman Sachs when the company threatened to move its headquarters to New Jersey." (citing David W. Chen, *Much Vilified, Financial Titans Find a Friend in Bloomberg*, N.Y. TIMES, Apr. 14, 2009, at A17)).

372. *See id.* ("Similarly, after the 2008 crash and in the face of the threatened departure of many venture capitalists from the city, the local government offered to invest roughly $45 million in seed capital to private sector enterprises in order to entice them to remain." (citing David W. Chen, *Economists' Forecast: Chance of Change 100%*, N.Y. TIMES, Feb. 16, 2009, at A17)).

373. *See* Colleen Curtis, *In Miami, President Obama Talks About His Plan to Put People to Work Rebuilding America*, WHITE HOUSE BLOG (Mar. 29, 2013), http://www.whitehouse.gov/blog/2013/03/29/miami-president-obama-talks-about-his-plan-put-people-work-rebuilding-america (last visited Mar. 30, 2015) (discussing President Obama's plan for creating jobs in Miami via the Port of Miami Tunnel project) (on file with the Washington and Lee Law Review); Laura Barrett, *6 Reasons to be Wary of Public–Private Partnerships*, HUFFINGTON POST (Apr. 5, 2013), http://www.huffingtonpost.com/laura-barrett/6-reasons-to-be-wary-of-p_b_3023410.html (last visited Mar. 30, 2015) (discussing various reasons to be wary of public–private partnerships like the one President Obama proposed in the Port of Miami Tunnel project) (on file with the Washington and Lee Law Review).

374. *See* Odinet, *supra* note 5, at 238 ("In essence, by clothing the private party with the trappings of governmental power, the playing field is necessarily rendered uneven such that other businesses and service providers cannot fairly compete.").

375. *See id.* at 239 ("The self-interested nature of these management arrangements can lead to a disproportionate share of risk being allocated to the

district, instead of having to personally sign the promissory note or personally guarantee the loan, the developer is able to spread the risk of the development's failure to the larger public.[376]

Moreover, in these supposed partnerships involving development special districts, the private party always has the leg-up.[377] The developer need not worry about control or oversight by the local government because he controls the district's board, and there are rarely any administrative mechanisms in place for the city to supervise its activities.[378] "The self-interested nature of these management arrangements lead[s] to a disproportionate share of risk being allocated to the private partner, rather than being evenly spread between the two."[379]

2. Winners, Losers, and the Uneven Playing Field

The haze created around the local government decision-making process when an economic development "win" is dangled before the eyes of decision makers usually leads municipalities into the open arms of the developer.[380] Important considerations of fairness, equality in the marketplace, and a level playing field easily fall away when the threat of losing the "deal" to another locale is looming overhead.[381]

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public partner, rather than being more evenly spread between the two.").

376. *See* Callies, *supra* note 27, at 23 ("Put simply, TIF creates funding by borrowing against future tax revenues that are expected to be generated by the redeveloped area."); Galvan, *supra* note 114, at 3060 ("MUDs, like many special districts, can take on significant debt without complying with the debt limitations imposed on the state, counties, or municipalities.").

377. *See* Odinet, *supra* note 5, at 237 ("[T]he hypnotic effect of garnering an economic development 'win' often leads local governments head-first into the open arms of private parties seeking development partnerships.").

378. *See* Galvan, *supra* note 114, at 3052 ("Developers tend to exert tremendous influence over MUDs' boards of directors . . . .").

379. Odinet, *supra* note 5, at 239.

380. *See id.* at 237 (discussing how economic desperation can lead certain municipalities into vulnerable relationships with private businesses); Barrett, *supra* note 373 (discussing how "financial desperation" has contributed to six troubling trends in public-private partnerships).

381. *See* Odinet, *supra* note 5, at 237 ("The promise of new infrastructure, jobs, and ongoing future growth creates a haze around the local government decision-making process such that many valid considerations are often let go by

Inherent in all public–private partnerships is the idea that a private individual is being clothed with public powers and resources in order to aid him in being successful.[382] However, the details and extent of the partnership are rarely well defined.[383] The relationship is typically sold as a shared endeavor whereby both parties incur some risk in return for some reward.[384] However, that is rarely the case.[385] The extent to which the developer bears any risk at all is often unclear to the general public (and perhaps even to the local government decision makers) in the development special district context.[386] It is the district that issues the bonds and is responsible for the debt service, not the developer.[387]

Moreover, justified resentment builds in other developers and private actors in the marketplace who do not receive such favorable treatment.[388] While other real estate investors must

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the wayside. One such important consideration is the role of fairness and competition.").

382. *See id.* at 238 (discussing how governmental preference often leads to an imbalance in private business competition); Dominique Custos & John Reitz, *Public–Private Partnerships*, 58 AM. J. COMP. L. 555, 558 (2010) ("While the public sector usually retains ownership in the facility or system, the private party will be given additional decision rights in determining how the project or task will be completed.").

383. *See* Odinet, *supra* note 5, at 237 ("However, in truth, the exact nature of the 'partnership' is often not well defined. The extent to which both parties—the public and the private—are on the hook for both capital investment and for incurring losses is often left vague and uncertain.").

384. *See id.* ("By engaging in these endeavors, local governments, at least nominally, are able to share both the risks and the rewards of a successful project with the private partner.").

385. *See id.* at 238 ("While clothed in the mantle of a shared endeavor where each party walks into the arrangement with eyes wide open, the end result of these arrangements are [sic] often quite different than what was anticipated.").

386. *See id.* ("[T]here is very little opportunity for the public to engage in meaningful oversight and management of the public private partnership relationship.").

387. *See* Callies, *supra* note 27, at 21 ("All states appear to permit the issuance of bonds as the principal method of financing a project through tax increment financing.").

388. *See* Odinet, *supra* note 5, at 241 ("This creates a malaise throughout the municipality as private enterprise refuses to further invest within the city's boundaries—either out of resentment or because they believe any such investment should be coupled with a public subsidy of their own.").

obtain conventional financing or equity participation and incur accompanying risk, the development special district parties need not do so.[389] And the more cities that use development special districts to give special benefits to only certain private parties, the more the municipality inadvertently sends a message that it is in the business of selecting winners and losers—a form of crony capitalism.[390] Some private groups will enjoy infrastructure subsidies, direct grants, tax breaks, and, in this case, special taxing district financing, while others are "forced to shoulder the burden on their own without public assistance."[391] The effect that results is a certain discontent across the jurisdictional market that results in private businesses refusing to invest in the area out of bitterness that they have not received a public subsidy or out of a holdout mentality in refusing to invest until they too receive government assistance.[392]

V. Recommendations for a Balancing of Interests

Development special districts have the potential to serve a valid purpose.[393] When used to truly help provide financing for

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389. *See id.* ("While some groups enjoy infrastructure subsidies and breaks from their tax obligations, others are forced to shoulder the burden on their own without public assistance.").

390. *See id.* ("In essence, public–private partnerships of this nature send a message to other private businesses in the area that the local government selects certain chosen winners, and thereby implicitly (though unintentionally) creates disfavored losers."). For a discussion of the related theories of rent-seeking and public choice economics, see Michael E. DeBowa & Dwight R. Lee, *Understanding (and Misunderstanding) Public Choice: A Response to Farber and Frickey*, 66 TEX. L. REV. 993 (1998); Kevin M. Murphy, Andrei Shleifer & Robert W. Vishny, *Why Is Rent-Seeking so Costly to Growth?*, 83 AM. ECON. REV. 409 (1993); Maxwell L. Stearns, *Restoring Positive Law and Economics: Introduction to Public Choice Theme Issue*, 6 GEO. MASON L. REV. 709 (1998).

391. *See* Odinet, *supra* note 5, at 241 ("While some groups enjoy infrastructure subsidies and breaks from their tax obligations, others are forced to shoulder the burden on their own without public assistance.").

392. *See id.* ("This creates a malaise throughout the municipality as private enterprise refuses to further invest within the city's boundaries—either out of resentment or because they believe any such investment should be coupled with a public subsidy of their own.").

393. *See supra* Part III.B (providing an overview of development special districts).

the development of areas that would otherwise be cut off from the lending market, their use is both legitimate and advantageous.[394] However, the desire of cities to draw in economic development projects and generate more tax revenue is too tempting.[395] It takes very few steps and little administrative process to create a development special district.[396] Moreover, it is all too easy for policymakers to convince themselves that the district's debt has no negative impact on the surrounding community.[397]

While the failure of the Beau Chateaux project is merely hypothetical, actual cases of development special district failures are not. In Florida alone, where development special districts are called community development districts, there were 594 districts created across the state.[398] In 2010, 42% of these districts where either "defaulting or not collecting enough money to make their payments."[399] These 123 at-risk districts have issued a combined total of over $4 billion in bonded indebtedness, which has been spread to financial houses, pension funds, and other large institutional investors across the country.[400]

One district in particular exemplifies the abuse.[401] The Arlington Ridge community development district in Leesburg issued $16 million worth of bonds.[402] This was used to support not only traditional infrastructure, but also a community restaurant

394. *See supra* Part III (discussing the special taxing district).

395. *See supra* Part II.C (discussing the economic and financial pressures of local governments as a result of the economic crisis).

396. *See supra* Part III.A (discussing the history and uses of special taxing districts).

397. *See supra* Part III (discussing the special taxing district concept).

398. *See* Ritchie, *supra* note 22 (discussing community development districts in Lake County, Florida, and across the state during the financial crisis).

399. *See id.* ("Today, Florida has 294 of these powerful districts that have borrowed billions by issuing bonds, and 123 of those—42 percent—are either defaulting or aren't collecting enough money to make their payments . . . .").

400. *See id.* ("So how much do the 123 districts combined owe bondholders? Nearly $4 billion.").

401. *See id.* ("Life at the Arlington Ridge retirement community south of Leesburg was considerably cushier before the developer went belly up.").

402. *See id.* ("Thanks to the greedy way Blair Communities financed the project, retirees who live on about 235 of the lots now are stuck with $15.9 million in bond debt.").

and other luxuries such as a social coordinator and a water aerobics instructor.[403] Shortly "[a]fter selling about 235 of the planned 1,036 lots in the 487-acre project, developer Blair Communities went belly up."[404] The effects of a failed development of this size, aside from the consequences to the homeowners and the investors, on the surrounding community can result in shock waves of economic depression and downturn as businesses and new investors flee from the area.[405]

The negative consequences that follow this free flowing public subsidy, particularly in the face of increasing municipal pressures to bring in new businesses, are substantial and have the potential to be even more so.[406] Recognizing the problems and stemming the damage is becoming tremendously important.[407]

A. Solution 1: Contractual Cures

One possible way to deal with the issue of the subordination of vested property rights and its impact on the real estate lending market would be to include an automatic default provision in all conventional lending documents.[408]

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403. *See id.* ("'We had a restaurant, full-time instructors for water aerobics, full-time security, social coordinators—they're all gone,' said Dominic Setaro, 62, a retired government finance officer."); White, *supra* note 8 (discussing the struggles of homeowners in failed tax districts).

404. Ritchie, *supra* note 22.

405. *See id.* ("The defaults are leaving folks like Setaro to uproot their retirement and fend for themselves in a morass of complicated government finance involving these so-called 'dirty bonds.' And they aren't the only ones hurt.").

406. *See supra* Part IV (discussing the various unintended consequences of development special districts).

407. *See supra* Part IV (discussing the urgency needed to address the various unintended consequences of development special districts).

408. For a discussion of contractual mortgage provisions, see Michael B. Mierzewski, Beth S. DeSimone & Tengfei (Harry) Wu, *New Law's Mortgage Provisions Affect Lenders, Mortgage Brokers, Appraisers, Settlement Service Providers, and Others*, 127 BANKING L.J. 702 (2000).

1. Implementing a Private Law Fix

In other words, using the example of Beau Chateaux, when Realty Bank first made the land loan to the developer, it could have provided in the loan agreement or mortgage contract that, in the event the borrower allows any special taxing district lien to attach to the mortgaged property without the mortgagee's consent, then this shall constitute an automatic default. By doing so, the real estate lender would be able to anticipate beforehand the chance that the developer would obtain special district financing and thus diminish the value of the bank's mortgage.[409]

Therefore, if the developer intended to obtain financing through a development special district, then he would first have to consult with his mortgage lender. In doing so, the mortgage lender would review the financial projections, economic studies, and other relevant information in connection with the magnitude of the proposed bond issuance and thereby police how much debt the special district would incur.[410] The lender would consent to the creation of the district if and only if the borrower agreed to follow what the bank dictates in issuing the bonds.[411]

2. Pondering the Drawbacks of Contract

However, there is a major drawback to this particular solution. First, the way in which special districts are created poses some problems insofar as lender's counsel has the ability to craft the appropriate language.[412] For one, it would be difficult to define and quantify when exactly a developer would "allow" a special taxing district lien to attach to the mortgaged property.[413] The local government is the body that creates the special

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409. *See generally* Christine M. Gimeno & Tammy E. Hinshaw, *Mortgage Acceleration Clauses*, 41 OHIO JUR. 3D ESTATES, ETC. § 262 (West 2014).

410. *See generally* Callies, *supra* note 27.

411. *See generally id.*

412. *See supra* Part III.B (providing an overview of development special districts).

413. *See supra* Part III.B.

district.[414] Although some statutory schemes require the landowner (developer) to file a petition, there are cases where the local government can, on its own, initiate the creation of the district.[415] Also, if the legislature creates the district via a special act, then the developer is not formally involved at all. So if one cannot quantify the developer's formal role in creating the district, can the lender expect its remedy to be triggered by informal acts?[416] If the developer writes to a legislator and asks her to sponsor a bill to create the development special district, does this constitute a default? What if the request to the legislator is made in the form of a conversation? Is it only a matter of proof now?

And what about other types of special taxing districts aside from the development special district? What if the locality votes to increase the property taxes in connection with the area's sewer district or fire district?[417] Would this constitute a default? It is, technically speaking, allowing the mortgaged property to be encumbered by a special district lien.[418] If there were a local election regarding the increase in the fire protection district's assessment, would the developer be compelled to vote against it in order not to violate the loan covenants? The issues raised here are difficult ones because the circumstances under which special districts arise can be so varied. This is particularly true because it is not the developer who legally creates the district.[419] Rather, it is a third party—the local government or the state legislature—who does so, and they are not bound by any special relationship with the developer's lender.[420] So, while a private law solution between the parties might have the potential to resolve some of

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414. *See supra* Part III.B.

415. *See supra* Part III.B.

416. *See* Galvan, *supra* note 114, at 3052 (discussing the benefits to developers of using special law MUDs).

417. *See supra* Part III.A (discussing the history and uses of special taxing districts).

418. *See supra* Part III.A (discussing special taxing districts).

419. *See supra* Part II.B (providing an overview of development special districts).

420. For more information on development special districts, see *supra* Part III.B.

the problems, it cannot be expected to serve as a comprehensive remedy.

B. Solution 2: Statutory Limitations

Statutory solutions also present a possible remedy to the problems related to the rampant creation of development special districts. In most cases, there are little to no statutory or constitutional parameters imposed on legislatures or local governments in their ability to create special taxing districts.[421] There is no formal process of deliberation, nor is there a list of factors that the legislative body must consider when determining whether to convey to a private party (or any party) the benefits of a special taxing district.[422]

1. Enacting Legislative Parameters

At the local government level, the developer and his architects, planners, and attorneys woo the city council or county commission with promises of high-end developments that will result in large tax revenues.[423] While the council may engage in some deliberative processes as to the merits of the project, studies have shown that more often than not the passage of ordinances creating such districts happens as a matter of course.[424] And those development special districts created by legislative act are even more easily obtained.[425] With so many members in the state house from so many far off corners of the state, it is easy to surmise that few (if any) will actively spar with the bill sponsor as to the legitimacy of a development special district in a particular far-flung town or county.

A possible solution might involve amending special taxing district statutes in every state to provide that the legislative

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421. *See supra* Part III.B (explaining development special districts).
422. *See supra* Part III.B.
423. *See supra* Part III.B.
424. *See supra* Part III.B.
425. *See supra* Part III.B.

body—whether state-wide or local—must review certain factors before approving a new special district, or perhaps that the body can only create special districts that meet certain criteria.[426] In the best case scenario, the development special district would only be used in those instances where the project could not occur without public support and that the project furthers the goals of ameliorating an economically depressed or underserved area.

2. Remembering the Inevitability of Discretion

However, the problem with this approach is that a determined and resolute legislative body that is intent on conferring the favored party with a special taxing district subsidy will find a way to justify the district's creation, even if it does not actually meet the criteria. When cities and municipalities are being pushed to drive economic growth and to spur new jobs and investment, there is little chance that local government decision makers—much less state legislators—will truly evaluate each development special district request with a discerning eye.[427] The developer would argue that the project is not possible without the subsidy because he is financially unable (or unwilling) to shoulder the burden of obtaining conventional financing. Or, perhaps he would argue that financing is not available or practical.

The council, in turn, would argue that the granting of the district does indeed help ameliorate an economically depressed area. If a previously undeveloped area becomes a booming neighborhood or commercial hub then, under a rising-tides-raise-all-ships theory, nearby underserved and depressed areas would benefit from the spill-over effect. And the local government would further declare that the revenues produced from the new tax base would be used to focus additional public subsidies to these

426. *See, e.g.*, Zale, *supra* note 81, at 87 ("This article argues that before exercising the right to destroy as a property owner, a city should conduct a demolition review procedure targeted at evaluating the impacts of the proposed exercise of the right to destroy on the city's resiliency.").

427. *See supra* Part II and accompanying discussion of pressures put on American cities post the Great Recession.

underserved areas in the future. With so many economic and political pressures facing cities today in terms of their role in the economic recovery, it is of little doubt that every development special district request would meet whatever criteria or narrow purpose the lawmaker could craft.[428]

C. Solution 3: Adopting a Two-Pronged Jurisprudential Approach

While a private law or contract-based solution has limitations, and while a statutory cabining of authority in relation to the creation of special districts has its weaknesses as well, there is another solution that could prove effective. This solution involves the adoption of a doctrine of equitable subordination by courts in dealing with a competition between development special district liens and pre-existing mortgage rights. As discussed above, the superpriority status accorded to the special district lien is what causes most of the problems.[429] But if there were a way for courts to police situations whereby special district liens were used in overreaching ways to the prejudice of the pre-existing rights of third parties, then developers and special district boards would be less motivated to abuse the device.

In other words, the developer would not be inclined to overreach in the issuing of the bonds for mere luxuries and amenities, nor would he try to obtain a special district for the development of an area that was already prime for development, if he would not be able to validly market to bondholders that they would have a first priority lien to secure their investments.[430] The bondholders will be less enthusiastic in investing in the project if they believe that their rights to repayment might be subordinated to the interests of another creditor (like Realty Bank).[431] Through

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428. *See supra* Part II.A (discussing the effects of the economic crisis on local governments).

429. *See supra* Part IV (discussing the various unintended consequences of development special districts).

430. *See supra* Part III.B (explaining development special districts).

431. For more information on development special districts, see *supra* Part III.B.

this system, market forces would disincentivize the developer from being overly aggressive in his use of the development special districts.[432]

The test would work as follows: when confronted with competing secured parties—the bondholders or district and their or its liens on the one hand, and the real estate lender's mortgage on the other—the court would engage in a two-step process of determining whether the superpriority status of the special district's lien should be respected or whether it should be subordinated to the pre-existing mortgage.

1. The Stand-on-Your-Own Prong

The first part of the test involves the court analyzing the "stand on your own" prong. Under this study, the court looks to whether the project could have been accomplished through the use of non-development special district financing. In other words, could the developer have obtained conventional financing or equity financing through traditional channels and achieved the same result as he did using the special district?

This inquiry would be challenged or substantiated through market analyses as to whether the area was prime for development or merely speculative, through economic studies to show the likelihood of a return on investment, and through an exploration of the creditworthiness of the borrower versus the amount of risk a conventional lender would be willing to bear based on the market and the type and scope of the project. If the answer was determined to be yes—that the project could have been accomplished using non-development special district financing—then the liens in connection with the district's debt should be subordinated to the rights of the pre-existing mortgagee. But if the answer was no—the project would *not* have been possible without the special district benefit—then the court would move on to the second prong.

432. *See supra* Part III.B (providing an overview of development special districts).

2. The Community Benefits Prong

The second part of the test is the "community benefits" prong. This prong involves the court asking whether the benefits conferred on the parcels within and by virtue of the special taxing district inure to the measurable benefit of an economically distressed area. The purpose here is to decipher whether, if the project in its current iteration could only have been achieved through the use of a development special district, this project actually benefits, in an assessable way, an economically troubled area.

This would be determined based on substantiated evidence of tangible benefits to an economically distressed area that is either within or near the development special district. In other words, does the development bring jobs, blight improvement, or other economic benefits to an area that is in need of investment, resources, and opportunity? These benefits cannot be merely abstract or intangible. There must be actual data and tangible evidence that support realistic projections as to the benefits that will accrue to the target area. And it is not enough that these benefits exist, but they must actually impact an economically distressed area. This might include a portion of the locality that is blighted, historically undeveloped or underdeveloped, populated with a high number of low-income individuals, or that suffers from a number of at-risk factors.

If the answer is yes—the project does indeed measurably benefit an economically distressed area—then the superpriority of the special district lien should be respected. However, if the answer is no, then the lien should be subordinated to the pre-existing rights of any mortgagees.

By creating such a framework, courts would be equipped with a tool for policing the inappropriate use of development special districts. The test does not invalidate the district as a whole or call into question the validity or the wisdom of its creation. Rather, it merely assesses, based on measurable factors, whether it would be constitutionally appropriate to subordinate the pre-existing property rights of secured parties to the district's rights in the property. Further, the test provides flexibility in that if only a portion of the district's financing is used for an improvement or infrastructure project that fails to meet the test, while another portion of the financing satisfies the two prongs, then a value-to-value subordination of the lien could occur. This would allow for the bifurcation of the lien's superpriority status so as not to unduly injure true community benefits resulting from the special district along with those benefits that are purely private.[433]

3. A Comparison to Other Equitable Doctrines

Moreover, such flexible tests are not without precedent in American law. United States courts have long employed various judicially created tests to help balance the interests of private parties, even when they do not produce a bright-line rule. In the bankruptcy context, federal courts use a theoretically similar, although structurally different, form of equitable subordination when a superior bankruptcy claimant acts in such a way as to injure the rights of junior creditors.[434] In these cases, the court can subordinate the superior creditor's claim to that of the junior creditor or force all other creditors—secured and unsecured—to be paid first before any payments are made to the bad-acting superior creditor.[435] In essence, this much broader authority allows federal bankruptcy judges to strip a valid lien of all its power and authority over collateral.[436] And while this power is

433. *See supra* Part III (discussing the special taxing district).

434. *See* 1 BAXTER DUNAWAY, LAW DISTRESSED REAL ESTATE § 7:57 (West 2014) (discussing bankruptcy courts' use of equitable subordination in cases when bankruptcy claimants act in ways to injure the rights of junior creditors).

435. *See* Jeremy W. Dickens, *Equitable Subordination and Analogous Theories of Lender Liability: Toward a New Model of 'Control,'* 65 TEX. L. REV. 801, 802 (1987) (explaining the various instances in which equitable subordination could be employed by the court).

436. *See* Rafael Ignacio Pardo, Note, *Beyond the Limits of Equity Jurisprudence: No-Fault Equitable Subordination*, 75 N.Y.U. L. REV. 1489, 1490 (2000) ("[T]he purpose of the [equitable subordination] doctrine is 'to reprioritize the order of allowed claims based on the equities of the case, rather than to allow or disallow the claim in the first instance.'"); Andrew DeNatale & Prudence B. Abram, *The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors*, 40 BUS. LAW. 417, 428 (1985) ("[T]he court generally may award any relief that it deems appropriate to undo the wrong and ensure that the liquidation results are equitable. This relief can include voiding of liens . . . .").

vaguely provided for in § 510(c) of the United States Bankruptcy Code,[437] it has generally been held to be within the providence of the courts to define its parameters and develop its usages.[438]

At the state court level, the doctrine of unconscionability serves as yet another example of how judges have shown a propensity to engage in the extra-statutory policing of private contracts. The doctrine of unconscionability can be traced back to early English law, which sought to provide prohibitions for certain contracts that "no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other."[439] Since that time, a multitude of American states have utilized this principle, as well as the United States Supreme Court.[440] Courts have often declared that the power to police private contracts in this manner is part of the judiciary's inherent and intrinsic powers.[441] Consequently, the

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437. *See* 11 U.S.C. § 510(c) (2012) (detailing the court's granted power of equitable subordination).

438. For case law on this issue, see Pepper v. Litton, 308 U.S. 295, 306 (1939); Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 323 (1939); Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims, 160 F.3d 982, 987–88 (3d Cir. 1998); First Nat'l Bank v. Rafoth (*In re* Baker & Getty Fin. Servs., Inc.), 974 F.2d 712, 718 (6th Cir. 1992); Benjamin v. Diamond (*In re* Mobile Steel Co.), 563 F.2d 692, 699–700 (5th Cir. 1977); Herzog v. Leighton Holdings, Ltd. (*In re* Kids Creek Partners, L.P.), 212 B.R. 898, 929 (Bankr. N.D. Ill. 1997); De'Medici v. Salson Express Co. (*In re* Lifschultz Fast Freight), 181 B.R. 346, 356 (Bankr. N.D. Ill. 1995); Ansel Props., Inc. v. Nutri/Sys. of Fla. Assocs. (*In re* Nutri/Sys. of Fla. Assocs.), 178 B.R. 645, 653 n.4 (E.D. Pa. 1995); Blasbalg v. Tarro (*In re* Hyperion Enters.), 158 B.R. 555, 563 (D.R.I. 1993); Braas Sys., Inc. v. WMR Partners (*In re* Octagon Roofing), 157 B.R. 852, 858 (N.D. Ill. 1993).

439. Earl of Chesterfield v. Janssen, 2 Ves. Sec. 125, 156, 28 Eng. Rep. 82, 100 (1750).

440. These cases include Mieske v. Bartell Drug Co., 593 P.2d 1308 (Wash. 1979); Industralease Automated & Scientific Equip. Corp. v. R.M.E. Enter., Inc., 58 A.D.2d 482 (N.Y 1977); C & J Fertilizer, Inc. v. Allied Mut. Ins. Co., 227 N.W.2d 169 (Iowa 1975); Weaver v. Am. Oil Co., 276 N.E.2d 144 (Ind. 1971); Baker v. City of Seattle, 484 P.2d 405 (Wash. 1971); Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843 (N.J. 1967); Seabrook v. Commuter Hous. Co., 338 N.Y.S.2d 67 (Civ. Ct. 1972); Fairfield Lease Corp. v. Pratt, 278 A.2d 154 (Conn. Cir. Ct. 1971); Educ. Beneficial, Inc. v. Reynolds, 324 N.Y.S.2d 813 (Civ. Ct. 1971); Lazan v. Huntington Town House, Inc., 332 N.Y.S.2d 270 (Dist. Ct. 1969); David v. Mfrs. Hanover Trust Co., 287 N.Y.S.2d 503 (Civ. Ct. 1968), *rev'd on other grounds*, 298 N.Y.S.2d 847 (App. Term 1969).

441. *See generally* Evelyn L. Brown, *The Uncertainty of U.C.C. Section 2-*

power is not derived from legislation, but rather from general jurisprudential and constitutional principles that allow the judiciary to refuse to enforce unfair contracts or provisions that are deemed too burdensome, onerous, or one-sided.[442] Courts generally look for evidence of overreaching by one party who is in a superior bargaining position to the disadvantage of another party who is in an inferior position due to education, language, economic status, or social demographic.[443] And although UCC Article 2 codified the doctrine of unconscionability, it had long existed under, and continues to be developed purely by, the judiciary.[444]

Just as these equitable doctrines have allowed courts to interpose fairness and equity between private parties, the two-pronged test articulated above could be similarly used to help ward off the harms that arise from development special district abuse. By ensuring that over-reaching developers are unable to bank on the unfettered use of development special districts and their superpriority liens, market forces and considerations of risk will ultimately scale back the aggressive use of these devices for purely private developments and better encourage their use for true community development that inures to the benefit of the wider public.

302: Why Unconscionability Has Become a Relic, 105 COMM. L.J. 287 (2000).

442. *See id.* at 287–88 ("One such [judicial] tool is unconscionability, . . . used since at least the eighteenth century to 'police' contracts that are grossly unfair and one-sided.").

443. *See id.* at 298 ("A court is to consider factors such as the age, literacy, and business sophistication of the party claiming unconscionability; the bargaining tactics of the other party to the contract; and the commercial setting of the sales contract.").

444. *See* Melissa T. Lonegrass, *Finding Room for Fairness in Formalism—The Sliding Scale Approach to Unconscionability*, 44 LOY. U. CHI. L.J. 1, 8 (2012) ("The drafters of the Uniform Commercial Code sanctioned the doctrine of unconscionability in Article 2, but did not define the term or establish a framework for its implementation. . . . The drafters of section 2-302 intentionally left the task of defining unconscionability . . . to the courts.").

VI. Conclusion

As cities continue to scramble for new sources of tax revenue in this post-recession economy, the magnitude and pace of municipal competition will only continue to rise and become more intense.[445] To that end, the use of public incentive packages and other subsidy offerings as a tool to lure economic development projects to a given locale will also continue to rise.[446] The special taxing district has already been shown to be a powerful tool in the city's arsenal, and municipalities have evidenced a willingness in the past to distribute these public subsidy devices to aid developers in financing their various projects.[447]

However, the unintended consequences of the use of special taxing districts in this manner cannot be understated.[448] First, the liens they produce undermine vested property rights without any of the protections accorded under traditional due process and deprivation of property analyses.[449] Parties with superior rights in property, such as mortgagees and first secured parties, are unjustly subordinated to the rights of the later arising special district lien merely because the enabling statutes accord them the same status as ad valorem property taxes.[450] However, this superpriority is misplaced because although traditional property taxes support a broad array of public goods and services, the

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445. *See supra* Part II ("As cities and municipalities across the United States became zealous in their desire to attract new residents and to land economic development projects, they became more willing . . . to bestow their guarded public powers and prerogatives into the hands of private developers to aid them in obtaining easy, fast cash.").

446. *See supra* Part III ("It is through these economic and social pressures that local government decision-making has been steered precariously toward the creation of more and more special taxing districts as an instrument for economic, financial, and cultural viability, which has in turn served as an invitation for abuse and poor policymaking.").

447. *See supra* Part III (providing information on the use of special taxing districts).

448. *See supra* Part IV (outlining the many unintended consequences of using special taxing districts to attract private developers).

449. *Supra* Part IV.A.

450. *Supra* Part IV.A.

resources and amenities supported by the special district liens are purely private.[451]

Second, these development special district liens can have a substantially negative impact on the secondary mortgage market.[452] As lenders can no longer be certain of their first position lien over the collateral, the ability to effectively market securities backed by these mortgages quickly becomes impossible.[453] Secondary market firms such as Fannie Mae and Freddie Mac will likely refuse to purchase these securities due to the inferior position (as it has shown a history of doing under similar circumstances in the past), which could result in the entire secondary market abandoning these types of loans.[454] And as primary lenders can no longer sell these mortgage loans on the secondary market, they will no longer be willing to lend in projects that are coupled with special taxing district financing, including projects in low-income and economically distressed areas where public subsidy financing of this sort is crucial.[455] Such a scenario is not merely hypothetical; rather, the exact same situation occurred a mere four years ago with the very similar PACE special taxing districts.[456]

And lastly, the give-away of these special financing districts inherently creates a political dilemma as to the creation of winners and losers and the proliferation of a financial and risk-based distortion in the local economy.[457] By bestowing private benefits on only certain investors and businesses and not on

451. *Supra* Part IV.A.

452. *See supra* Part IV.B ("[O]ther creditors with vested property interests in the form of security rights are subordinated to the special district's interest. And this subordination . . . has a serious impact on the conventional real estate lending market as a whole.").

453. *Supra* Part IV.B.

454. *Supra* Part IV.B.

455. *Supra* Part IV.B.

456. *Supra* Part IV.B.

457. *See supra* Part IV.C ("And the more cities use development special districts to give special benefits to only certain private parties, the more the municipality inadvertently sends a message that it is in the business of selecting winners and losers—a form of crony capitalism.").

others, a general climate of crony capitalism is created, which substantially undermines the goals of the resilient city.[458]

A possible solution to this problem involving special taxing districts might entail the use of private law cures.[459] In other words, mortgage lenders might attempt to contractually anticipate and prevent the creation of special taxing districts and the resulting damage to their collateral position.[460] However, as discussed above, the ways in which various state and local laws dictate the creation of the districts make precise drafting almost impossible.[461] Another solution might involve enacting public law parameters to hem in local governments and legislators from creating special districts when they are meant for purely private purposes.[462] But such parameters, when so closely tied to the discretion of the lawmaker, will likely prove insufficient because a determined city council or legislature will find reasons—even if only superficial—to argue that the project has merit.[463] Moreover, such an *ex ante* limitation may have the result of unduly questioning the validity of local government policymaking even when there does not yet exist a bona fide dispute among private parties as to their lien rights in property.[464]

Finally, this Article argues for the adoption of a two-pronged jurisprudential test that seeks to provide a more nuanced framework to police the competing interests of lien claimants in the real-estate-related special taxing district context.[465] For the special district lien to enjoy its superpriority, the test would require that the special district subsidy be necessary for the

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458. *Supra* Part IV.C.

459. *Supra* Part IV.A (discussing the various methods of using private law to cure the defects of special taxing districts).

460. *See supra* Part V.A (proposing contractual cures to deal with the subordination of vested property rights).

461. *Supra* Part V.A.

462. *See supra* Part V.B (discussing the use of statutory limitations on the creation of special districts that serve merely private purposes).

463. *Supra* Part V.B.

464. *Supra* Part V.B.

465. *See supra* Part V.C ("This solution involves the adoption of a doctrine of equitable subordination by courts in dealing with a competition between development special district liens and pre-existing mortgage rights.").

financial viability of the project and that the project create a tangible and measurable benefit to an economically distressed area or population.[466] Such a test would allow an appropriate level of flexibility for the legitimate use of special taxing districts and would build upon a combination of other jurisprudential and discretional doctrines that already exist in American law.[467] Special taxing districts used for real estate developments have and can continue to play an important role in the recovery of the American economy.[468] Areas that are hit the hardest, such as those that are economically distressed and where the cost of development is too high compared to the potential return, stand to benefit from such a public subsidy.[469] However, this public benefit comes with consequences that, if abused, can unjustly harm private rights in property, diminish certain forms of community lending, and distort the field of equal economic opportunity in a given jurisdiction.[470] Through the adoption of the flexible approach described above, to be administered under the neutral eye of the courts, the inherent lien priority contest involved in special district real estate projects can be moderated so as to maintain the integrity of this type of financing device.[471]

466. *Supra* Part V.C.

467. *Supra* Part V.C.

468. *See supra* Parts II–III (discussing the use of special taxing districts in order to reinvigorate municipalities struggling during the Recession).

469. *See supra* Part III (discussing how, for some districts, the use of special taxing districts in order to encourage public–private partnerships is the only practical option).

470. *See supra* Part IV (discussing the need to use special taxing districts cautiously due to their many unintended bad consequences).

471. *See supra* Part V.C (discussing the suggested two-pronged approach courts could use to employ equitable subordination when special district liens and pre-existing mortgage rights are in conflict).