

Legal Q&A

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What are the allowable means of selling real property held by a city?

Real property (i.e., any property that is attached directly to land, as well as any right or ownership interest in the land itself) owned by a city must generally be sold by: (1) public auction under Local Government Code chapter 253; (2) notice and bidding procedures under Local Government Code chapter 272; or (3) in the case of a home rule city, the use of a broker under new legislation passed in 2013.

Section 253.008 of the Local Government Code provides that:

- (a) The governing body of a municipality may sell real property owned by the municipality by public auction or by sealed bid under Section 272.001.
- (b) To sell real property by public auction, the governing body of a municipality shall publish notice of the auction before the 20th day before the date the auction is held. The notice for sale of the real property must be published once a week for three consecutive weeks before the date the auction is held in a newspaper of general circulation in the county in which the municipality is located and, if the real property is located in another county, in a newspaper of general circulation in the county in which the real property is located. The notice must include a description of the real property, including its location, and the date, time, and location at which the auction is to be held.

Section 272.001(a) of the Local Government Code provides, in relevant part, that

before land owned by a political subdivision of the state may be sold or exchanged for other land, notice to the general public of the offer of the land for sale or exchange must be published in a newspaper of general circulation in either the county in which the land is located or, if there is no such newspaper, in an adjoining county. The notice must include a description of the land, including its location, and the procedure by which sealed bids to purchase the land or offers to exchange the land may be submitted. The notice must be published on two separate dates and the sale or exchange may not be made until after the 14th day after the date of the second publication.

A new method is now available to home rule cities. Senate Bill 985, passed in 2013 and effective immediately, allows a home rule city to sell property in almost the same way as a private owner, with no competitive procedures required. Specifically, the bill adds Section 253.014 of the Local Government Code, which reads as follows:

- (a) In this section, “broker” means a person licensed as a broker under Chapter 1101, Occupations Code [i.e., a state-licensed real estate broker].
- (b) The governing body of a home-rule municipality may contract with a broker to sell a tract of real property that is owned by the municipality.

- (c) The governing body may pay a fee if a broker produces a ready, willing, and able buyer to purchase a tract of real property.
- (d) If a contract is made under Subsection (b) with a broker to list the tract of real property for sale for at least 30 days with a multiple-listing service, the governing body on or after the 30th day after the date the property is listed may sell the tract of real property to a ready, willing, and able buyer who is produced by any broker using the multiple-listing service and who submits the highest cash offer.
- (e) The governing body may sell a tract of real property under this section without complying with the public auction requirements prescribed by Section 253.008 or other law or the notice and bidding requirements prescribed by Section 272.001 or other law.

What are the exceptions that allow a city to sell real property without complying with notice and bidding or public auction?

In addition to the new authority for a home rule city to use a broker, Chapters 253 and 272 both contain a number of exceptions to the competitive process. Many of them are “bracketed” (i.e., limited to use by one or a few cities). Some of the more frequently used examples from Chapter 253 include:

- **Section 253.010 – Housing Nonprofits:** Sale to a nonprofit organization that develops housing for low-income individuals and families as a primary activity to promote community-based revitalization of the city or a religious organization that owns other tax-exempt property in the city and has entered into a written agreement with the city regarding the revitalization of the land.
- **Section 253.011 – Nonprofits:** Sale to certain nonprofit organizations so long as the city receives consideration in the form of an agreement between the parties that requires the nonprofit organization to use the property in a manner that primarily promotes a public purpose of the city. The instrument of transfer must provide that, if the nonprofit organization at any time fails to use the property in that manner, ownership of the property automatically reverts to the city.
- **Section 253.012 – Economic Development Corporations in Smaller Cities:** Sale by a city with a population of 20,000 or less to an economic development corporation so long as the city receives consideration in the form of an agreement between the parties that requires the economic development corporation to use the property in a manner that primarily promotes a public purpose of the city. The instrument of transfer must provide that, if the economic development corporation at any time fails to use the property in that manner, ownership of the property automatically reverts to the city.

Chapter 272 contains over a dozen exceptions. Some commonly used exceptions in Section 272.001(b) include:

- narrow strips of land, or land that because of its shape, lack of access to public roads, or small area cannot be used independently under its current zoning or under applicable subdivision or other development control ordinance;
- streets or alleys, owned in fee or used by easement;
- land or a real property interest originally acquired for streets, rights-of-way, or easements that the city chooses to exchange for other land to be used for streets, rights-of-way, easements, or other public purposes, including transactions partly for cash; and
- a real property interest conveyed to a governmental entity that has the power of eminent domain.

While the notice and bidding requirements do not apply to the exceptions above, the real property may not be conveyed, sold, or exchanged for less than the fair market value of the land or interest unless the conveyance, sale, or exchange is with one or more abutting property owners who own the underlying fee simple. (That usually applies when a city has abandoned and conveyed a street or utility easement to the underlying owner.)

The fair market value is determined by an appraisal obtained by the city. (Note: in the case of a home rule city, the fair market value may be determined by the price obtained by the city at a public auction for which notice to the general public is published in the manner described by Section 272.001(a)[shown in the first question of this Q&A]. The notice of the auction must include, instead of the content required by Subsection (a), a description of the land, including its location, the date, time, and location of the auction, and the procedures to be followed at the auction.) The appraisal or public auction price is conclusive of the fair market value of the land or interest, regardless of any contrary provision of a home rule charter.

Must a city obtain an appraisal prior to selling real property by public auction or notice and sealed bid?

Maybe. The concepts of fair market value and appraised value are somewhat intertwined.

The premise underlying an appraisal requirement is founded in the Texas Constitution. Article III, Section 52, and Article XI, Section 3, prohibit the legislature from authorizing any county, city, or other political subdivision of the state to lend its credit or grant public money or anything of value in aid of an individual, association, or corporation. This means that a city may not sell property it owns for less than the “fair market value.”

By definition, the sale of property at its fair market value does not violate the constitution. “It has been uniformly held that the resale of property at its fair [market] value is not a gratuity or an extension of public credit.” Tex. Atty. Gen. Op. No. GA-0634 (2008) (citing *Davis v. City of Lubbock*, 326 S.W.2d 699, 709 (Tex. 1959) (rejecting the contention that property purchased by a city for urban renewal “may not be resold at its ‘fair value’ which might be less than the [city’s] cost of acquisition and clearance of such land”)); *see also* Tex. Att’y Gen. Op. No. GA-0371 (2005) at 3 n.4 (“Certainly a land sale for fair market value could not be challenged as a

gratuitous transaction.” (citing *Walker v. City of Georgetown*, 86 S.W.3d 249, 260 (Tex. App.—Austin 2002, pet. denied)).

How does this relate to whether an appraisal is required? Under Section 272.001(b), a city must obtain an appraisal if it is selling real property *without* an auction or notice and bidding, pursuant to an exception. That makes sense: no competitive process equals the need for appraisal. Without a competitive process to determine fair market value, an appraisal is the only means to do so.

On the other hand, consider property sold pursuant to a competitive process. In that case, the highest bid should actually—and as a practical matter—determine the real property’s fair market value and negate the need for an appraisal. In other words, if the highest bidder is only willing to pay a certain price, the argument is that the city isn’t giving away anything in violation of the constitution, because that is the highest price it can get.

That position is in line with Texas case law defining “fair market value” broadly as the “price the property will bring when offered for sale by one who desires to sell, but is not obligated to sell, and is bought by one who desires to buy, but is under no necessity of buying.” Tex. Atty. Gen. Op. No. GA-0634 at 3 (2008)(citations omitted). In fact, the attorney general concluded that “fair market value is generally understood to mean a fixed, ascertainable sum.” Tex. Atty. Gen. Op. No. DM-441 (1997) at 4-5.

The position above appears to have been a common one. However, cases dealing with county procedures have called it into question. For instance, in *Killam Ranch Props., Ltd. v. Webb Cnty.*, the court concluded that a county selling land under the authority of Section 272.001(a) *must obtain an appraisal prior to doing so*. *Killam Ranch Props., Ltd. v. Webb Cnty.*, 376 S.W.3d 146, 154 (Tex. App.—San Antonio 2012, pet. denied).

The court’s reading of the statute is nonsensical:

Although section 272.001 is silent as to the appraisal requirement, the court in *Collins* determined there was an implied appraisal requirement in 272.001 because subsections (b), (f), and (h) all refer to the determination of fair market value by appraisal, and all the subsections refer to the sale of land for fair market value determined either by appraisal or by public auction. *Collins*, 954 S.W.2d at 147-148; *see also* Op. Tex. Att’y Gen. No. DM-232 (1993).

Moreover, we find that a reading of Section 272.001(a) in the context of Section 272.001 as a whole makes it clear that Section 272.001(a) intends units of state government to obtain an appraisal in order to ascertain fair market value. *Collins*, 954 S.W.2d at 149.

Id. (discussing *Collins v. County of El Paso*, 954 S.W.2d 137 (Tex. App.—El Paso 1997, pet. denied)).

Essentially, both the San Antonio and El Paso Courts of Appeal have erroneously inserted an appraisal requirement in a statute that has none. Nevertheless, cities in those appellate districts

should arguably follow their holdings. Cities in other parts of the state may wish to do so, as well.

Must a city accept the highest bid when selling real property by notice and sealed bid?

Chapter 272 of the Local Government Code doesn't expressly require it. Section 272.001(a) governs the sale of real property by notice and sealed bid. Under that section, a city must publish notice in a newspaper of general circulation in the county in which the land is located, or if there is no such newspaper, in an adjoining county. The notice must describe the land and the procedure by which sealed bids to purchase the land may be submitted.

Cities are required to follow the procedures set forth in Section 272.001(a), described above. However, Section 272.001(d) provides that "[t]his section does not require the governing body of a political subdivision to accept any bid or offer to complete a sale or exchange."

So long as the city determines that a bid provides the best benefit for the taxpayers of the city *and the bid conforms to the bid procedures and specifications set forth in the published notice*, the governing body may be able to accept a bid that is lower than the highest bid received. *See, e.g., West Orange-Cove Consol. Indep. Sch. Dist. v. Smith*, 928 S.W.2d 773 (Tex. App.—Beaumont 1996, no pet.) (Discussing a similar school district provision in the Education Code and observing "that the purpose of bidding is to stimulate competition, prevent favoritism and secure the best [results] for the best interests and benefits of the taxpayers.")

Of course, some attorneys disagree. In addition, the position above is complicated by the fair market value issue in the previous question.

Must a city accept the highest bid when selling real property by public auction?

Yes. Section 253.008 provides an alternative to selling land by the notice and sealed bid procedure of Section 272.001.

Section 253.008(a) provides that "[t]he governing body of a municipality may sell real property owned by the municipality by public auction or by sealed bid under Section 272.001." An "auction" is defined as a "sale of property to the highest bidder." BLACK'S LAW DICTIONARY (8th ed. 2004). Thus, if a city chooses this method to sell land it owns, the property must go to the highest bidder.

Is a lease of a city's real property subject to notice and bidding?

Probably not. Section 272.001(a) of the Local Government Code provides that the notice and bidding process applies to the "sale or exchange" of land owned by a political subdivision. There is no language indicating the provision is applicable to the lease of city land.

Moreover, in *Walker v. City of Georgetown*, the Austin Court of Appeals held that a city's temporary lease of parkland (10 years with an option for 10-year renewal) is not subject to the

notice and bidding requirements in Chapter 272. *Walker v. City of Georgetown*, 86 S.W.3d 249, 259 (Tex. App.—Austin 2002, pet. denied).

In deciding that the city was not subject to notice and bidding requirements, the court reviewed the language of Chapter 272. Because the statute only referenced the “sale or exchange” of land as necessitating the requisite formalities, and not the lease of land, the court held that the drafters of the statute did not intend for a city to be subject to these requirements when leasing parkland: “[T]he plain language of the statute indicates that the Legislature intended for the notice and bidding requirements to apply to the ‘sale or exchange’ of land, not the lease of land.” *Id.*

While the *Walker* decision restricts the applicability of Chapter 272, the case is arguably applicable only to temporary lease arrangements similar to the potential twenty-year lease involved in the case.

Under what circumstances would a city’s lease of real property not be considered temporary, and therefore subject to the notice and bidding procedures in Chapter 272?

Several factors must be considered in determining whether or not a lease is essentially the same as a sale or exchange of land subject to Chapter 272. A recent attorney general opinion suggests that the following all have a bearing upon the status of the lease agreement: (1) the duration of the lease; (2) the city’s right to control the land during the lease term; and (3) the city’s right to make improvements upon termination of the agreement. Tex. Att’y Gen. Op. No. GA-0321 (2005) at 9. An older opinion suggests that the lessee’s option to purchase the leased property upon expiration of the lease may also be indicative of a sale. Tex. Att’y Gen. LO-96-053, at 3.

The attorney general has suggested that a lease of city land in excess of fifty years may equate the lease to a sale or exchange, putting it within the ambit of Chapter 272. One court has indicated that a lease agreement exceeding forty years may be considered “extremely lengthy,” which indicates that forty years may be the outer limits of being characterized as a lease for purposes of Section 272.001 of the Local Government Code. *See Flagship Hotel, Ltd. v. City of Galveston*, 117 S.W.3d 552, 559 (Tex. App.—Texarkana 2003, pet. denied).

There is no clear test to determine when a lease goes from being “temporary,” and thus not subject to notice and bidding requirements, to “long-term,” which might make the lease the equivalent of a “sale or exchange,” and thus subject to the notice and bidding requirements. Opinions from the attorney general, as well as a limited amount of case law, indicate that leases with a duration in excess of forty to fifty years could rise to the level of a “sale or exchange.”

Each city should consult with local legal counsel to review the facts and law associated with a lease of real property.

Are there additional procedures that may apply to the sale of specific types of real property?

Yes. For example, Texas Government Code Section 1502.055 provides that, before a city may sell a utility system, the governing body must order an election on the question. The election

must be held, regardless of whether the utility system is encumbered with debt. Section 1502.055 also requires an election on the question of the sale of a city park or pool. These examples aren't exhaustive, and a city must also comply with competitive procedures discussed above.

Essentially, any time a city is planning on disposing of real property, local legal counsel should be consulted to ensure that the appropriate procedures are followed.