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Mayor and City Council  
City of Boerne  
Boerne, Texas 78006

Dear Mayor and Council:

This is an open letter containing my comments regarding the proposed Development Agreement with MA Boerne Partners, LP.

Here is the environment in which Esperanza will commence:

in 2007, Texas housing starts and new-home sales both dropped more than 25 percent, and a continuing slump is expected in 2008;

KB Homes lost \$773 million in 2007;

Centex Homes lost \$975 million through the third quarter of 2007;

Pulte Homes lost \$875 million in 2007;

Standard Pacific lost \$326 million through the third quarter, and has hired bankruptcy counsel;

Kimball Hill lost \$220 million in 2007, has defaulted on its loans and is teetering on bankruptcy.

Under the development agreement, the city will be obliged to spend millions of dollars on infrastructure, as will the developer. Boerne's substantial investment mandates that the city have reasonable assurances that the project will succeed, and that the developer will honor its obligations. If the project encounters difficulties, Boerne must be sure that it will not be left holding the bag. Unfortunately, the existing contract does not provide that protection. In fact, it is dangerously deficient in that regard. The deficiencies can and should be corrected before any development contract is inked.

Let me explain from the beginning. Because Marlin Atlantis is privately held, we know nothing of its finances. But we do know this: MA Boerne is not Marlin Atlantis. It appears to be a typical real-estate-development shell, some unknown number of layers below some unknown number of owners or partners, meant to shelter the assets of whoever is the ultimate owner.

The most likely situation is that MA Boerne owns the land in question and very little else. Who will provide the money to perform? The developer will seek financing (in this difficult market) and someone in the long chain of ownership will inject cash as he, she or it deems appropriate. We have no information on the financial condition of MA Boerne, and no concrete evidence that it can successfully attract a lender.

Sadly, it wouldn't matter if MA Boerne were supremely financially robust. MA Boerne can slip out of all its obligations to Boerne with just a few strokes of the pen. It can transfer the Esperanza property to a penniless wholly-owned subsidiary and assign the development agreement to the subsidiary. It would then have no further responsibility to execute the agreement. (See Article 10.3.)

In all likelihood, we're already in that position—MA is almost certainly an under-funded sub where the true owner has placed the land to avoid having any direct obligations to Boerne and to avoid risking too much cash. The true owner won't put much money into MA Boerne unless someone forces it to properly capitalize. If a lender materializes, it will surely require financial commitments, but real-estate development financing efforts in today's climate may or may not succeed. What happens if the no-financing news arrives after Boerne has begun expanding roads and laying water and sewer lines? What happens if MA Boerne secures financing but, like many developers at present, suffers poor sales and defaults on its loans? The lender can look to the land for repayment; Boerne cannot.

Boerne has not conditioned any of its millions of dollars in obligations upon the developer obtaining any financing for its project. Nor has Boerne conditioned its obligations upon the developer avoiding default on its financing or meeting any other minimal financial test. There are no home-sales targets or revenue targets that qualify Boerne's obligations to subsidize the project. Boerne may be obliged to build infrastructure for a failing subdivision, pouring taxpayer money into a bankrupt enterprise.

As matters stand today, if financing does not emerge, or if the project goes sour, the true owner can simply stop putting in cash. The owner might lose the partially developed land (to creditors, not to Boerne), but would have no other downside whatsoever. The city could sue and demand performance of the agreement, but you can't make a dead horse run.

It gets worse. Unlike every other person with whom the developer will be doing business, the city cannot extract damages for the developer's failure to perform. It cannot recover any money that it spent on the failed subdivision. It cannot get a court judgment and execute against the property. It has no lien, and cannot take the land to fund the performance of the agreement. It has no payment or performance bonds upon which to collect. It cannot even terminate the agreement. Basically, it can complain. (See Article 9.2.)

It gets worse again. Despite its complaints, despite the developer's default, the city would still be obligated to continue its performance of the agreement. (Note that Article 5.1(a)(1)

requires the city to keep performing even though the developer defaults, while Article 5.1(a)(2) requires the developer to perform only if the city is performing.)

And then it gets worse yet. Facing a default, or just being clever, the developer could put five acres into a penniless subsidiary, then assign all of the Major Infrastructure construction obligations to the subsidiary. Poof, the developer has virtually all of the land and none of the important obligations of the development agreement. (See Article 10.2.) If the subsidiary defaulted and/or lurched into bankruptcy, the developer would not even lose the land to creditors. It could wait for the development agreement to expire, wait for the bankruptcy court to void it, or—worst of all—continue to develop and sell the land while referring all Boerne complaints to the defunct subsidiary. (The developer's principal lenders would be too smart to draft documents that allow this maneuver, but the ordinary creditor is not. Neither, apparently, is Boerne.)

In other words, any decent lawyer could quickly move all the obligations into a shell, leaving the land (subject to the agreement, but free of the duty to perform it) in MA Boerne, which could then sell the land or relocate it somewhere within the Marlin Atlantis matrix. Boerne, having invested millions in sewer and water infrastructure, perhaps still facing millions in obligations, would have a fragile landless partner, would have virtually no enforcement leverage, would be on the hook for its share of infrastructure and—if the shell tumbled into bankruptcy—could see the developer's obligations go up in smoke. And MA Boerne would still own the land.

This is, of course, an enormous hole in the contract. I spent twenty-five years negotiating transactions, including major real estate transactions; these provisions take my breath away.

I wish this gaping loophole were the only problem with the contract. It is not. Here are a few points that I glean from the agreement:

Unlike the situation facing every landowner in Boerne, the zoning code is frozen as to Esperanza at the moment that the agreement is signed. The laws may change for the rest of us, but not for Esperanza. (See Article 2.1(f).)

If the city imposes new fees on developers, Esperanza will be exempt. (See Article 4.7.)

Most Boerne subdivision ordinances do not apply to Esperanza. The few construction-type ordinances that do apply (See Exhibits F and G) are frozen in time for Esperanza, though not for any other local developer. (See the last paragraph of Article 2.1.) Here are some consequences of that exemption:

Being exempt from Article II of our Utilities Ordinance, Esperanza is free of restrictions on the following matters:

Water for construction  
Turf management  
Native grasses  
Year-round water conservation  
Prohibited uses of water  
Permits for newly planted lawns and landscaping

Being exempt from Article III of our Utilities Ordinance, Esperanza is free of restrictions on the following matters:

Septic tanks  
Privies not allowed

The development agreement contemplates that some sort of future architectural control committee created by the developer will adopt rules for drought-tolerant planting, but—as noted above—it does not subject the subdivision to Boerne’s turf-grass ordinance or other planting rules, present or future. (Thus, among other things, the large-lot owners at the north end of Esperanza can plant their entire acreage with whatever turf grass they wish, and irrigate the whole thing.)

Esperanza will not be subject to Boerne’s Oak Wilt Ordinance, even though their oaks can easily infect trees in Boerne.

Esperanza will not be subject to Boerne’s Construction Noise Ordinance (surely much to the dismay of nearby Boerne citizens for the next fifteen years).

Because of the inadequacy of online resources, I cannot figure out the interplay between the development agreement, Boerne’s subdivision regulations (Ord. 2007-56) and Boerne’s Development Plat Regulations (Ord. 2004-04), but I am concerned about the risk that:

Esperanza may be exempt from the road and utility payment and performance bonds required of every developer under Boerne’s Development Plat Regulations; and

Esperanza will not be subject to Boerne’s Tree Ordinance, allowing the developer to clear-cut the property as it wishes.

The impact fees to be charged by Boerne are limited to charges for new water and sewer infrastructure created for Esperanza only. (See Article 4.4.) Although the Texas statute regarding impact fees also allows fees to cover the costs of upgrading, updating, expanding, or replacing existing capital improvements to serve the new

development, the development agreement prohibits recovery of these costs, even though they may be significant.

You may be familiar with the nightmare of developers' claims to "vested" or "protected" development rights. If Esperanza can come up with any of those, they trump the development agreement (See Article 12.3). Just the opposite should apply—in exchange for its development rights, Esperanza should waive any potentially superior rights.

Why is there no express prohibition against Esperanza and its buyers incorporating into an independent city? The developer consents to annexation at some time in the future (Article 7.4) but does not promise not to incorporate, not to seek annexation to any other municipality. What happens if Esperanza residents—perhaps angered over high taxes, poor construction, orphaned ETJ status and the strictures of the development agreement—defiantly incorporate a new city, frustrating our annexation rights and creating a legal mess?

Why is there no express well-drilling prohibition upon Esperanza or the businesses and residents that buy from Esperanza? (Article 5.1(a)2.E.(vi) prohibits individual homeowners from drilling wells for irrigation, but not for potable water; Article 5.5 conveys an existing well to the city but fails to prohibit any new Esperanza wells.) Given the necessary acreage or use, Esperanza and its buyers can drill at will. They can use the water or sell it. Similarly, I find no prohibition on private septic systems. (Note that Esperanza is exempt from Article III of our Utilities Ordinance.) The situation seems to be that the city must provide water and sewer, and the developer can pursue alternatives if the city doesn't, but nowhere is the developer or any of its buyers prohibited from drilling wells or installing septic systems. Isn't exclusivity of service a fundamental part of our agreement to provide the service? Only Boerne, which has the obligation to provide water, should have the right to drill wells.

The city has committed to use its "best efforts" to obtain necessary TxDOT approvals. (Article 5.1(c)(1)). This is generally considered a dangerous standard of performance, because parties are prone to claim that anything possible must be done. Regardless of whether it makes economic sense. Regardless of whether it meets common sense. Regardless of whether it is disastrous. Only the brave accept even a "reasonable best efforts" standard. Most negotiators require something along the line of "reasonable and diligent efforts."

Boerne warrants that it has and will have the sole and exclusive right to control development of the tract. (Article 2.6.) That question is a matter of law, and the law may change. Why would Boerne warrant something it cannot control, especially in a contract where the other party doesn't even warrant that it owns the land?

And finally, in the category of smoke and mirrors, there is the pitiful “foundation fund.” (Article 7.7.) MA Boerne is going to put one percent of the gross proceeds of residential (not commercial) lots and improvements into the fund. But the fund doesn’t exist yet. It has no stated purpose. It might not be non-profit. Its board is unknown. The so-called foundation fund could turn out to sponsor fishing trips for the developer’s sales staff. This provision, acceded to by city staff, is a final insult to the Boerne citizens that Marlin Atlantis tried to dupe with hollow promises of community generosity. It reeks of cynicism.

The agreement is a disaster, an embarrassment for the city. It reads like a sophisticated big-city developer sticking it to small-town amateurs. Why does that matter? Four major reasons come readily to mind.

First, we are in the midst of a real-estate meltdown. The subprime mortgage racket is bringing down major investment banks. Credit is drying up. New home sales are plunging. Developers are withering. Across Highway 46 from Esperanza, KB Homes is falling far short of its sales projections. There is good reason to doubt whether MA Boerne can arrange the financing needed to develop the tract. There is even more reason to doubt whether the tract can be developed during the fifteen-year term of the agreement. The potential for failure at Esperanza is significant. Boerne should protect itself with a competently drawn development agreement that aggressively protects the city from the consequences of developer collapse.

Second, this development will become the model for all of Boerne’s future development agreements. It is a public document. The next developer in the door will demand all of the exemptions, freezes, immunities, financial escapes and weak enforcement that this agreement suffers. This agreement will be waved in the face of the poor negotiator who tries to cut a better deal for the city. Boerne may well be sued if it tries to materially depart from this form of agreement. It has a serious impact as precedent.

Third, Boerne may well be sued by present and future developers who find themselves subject to new ordinances and fees, while Esperanza claims exemption. Yes, Esperanza’s rights are from a contract in the ETJ, not an ordinance in the city, but will the special treatment of Esperanza hold up under challenge? One deal for them, another deal for everyone else? An agreement to prospectively exempt Esperanza from future laws? No developer in the city gets that deal. Even if the agreement holds up, you might end up spending a lot of money on litigation. The best you can hope for is buckets of ill will from developers who are not given special treatment.

Fourth, you’re probably lucky that no one has already brought a quo warranto suit, asking for an injunction against this weak and unusual deal that may just extend beyond the city’s powers and might abdicate its responsibilities. In a more aggressive community, you would already be in a deposition. When your lawyers tell you that

you should fight the case, ask them how much it would cost to defend and who would get the fees.

Regardless of how you feel about Esperanza, regardless of where you are on growth or density or traffic, this is not a contract that conscientious city council members could accept. The development agreement would give Boerne a reputation it neither wants nor deserves.

Thank you for the opportunity to comment on this important matter.

A handwritten signature in black ink, appearing to read 'Jefferson Morgenthaler'. The signature is fluid and cursive, with several loops and a long horizontal tail extending to the right.

Jefferson Morgenthaler

GJM/okcb