

**Municipal Finance: The Public Purpose Doctrine and  
the Basics of Borrowing, Depositories, and Investments**

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**By**

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## Purpose

The purpose of this paper is to provide a primer of the following areas of municipal finance: the public purpose doctrine, and the basics of borrowing, depositories, and investments. Each section provides statutory references; secondary resources (including hyperlinks to Internet resources); and an outline of general issues. My intent was to provide a framework to develop a basic understanding of the listed areas of municipal finance and to provide a foundation or starting point for researching issues in these areas.

### I. PUBLIC PURPOSE DOCTRINE

#### A. Authority

##### 1. Texas Constitution Art. 3, §52

a. This section states in relevant part: “[T]he Legislature shall have no power to authorize any county, city, town or other political subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association, or corporation whatsoever . . . .”

##### b. Exceptions

- 1) **Economic Development:** Texas Constitution Art. 3, §52-a is an exception to the general rule provided by Art.3, §52, which generally prohibits a city or other political subdivision of the state from lending its credit or granting public money to an individual, association, or corporation. Art. 3, §52-a allows the legislature to provide for the use of public money for economic development purposes. The legislature enacted Chapter 380 of the Texas Local Government Code to authorize cities to provide assistance for economic development, including programs for making loans and grants of public money.
- 2) **Donation of Outdated/Surplus Fire Equipment:** Texas Constitution Art. 3 authorizes a city to donate to underdeveloped countries outdated or surplus equipment, supplies, or other materials used in fighting fires (§52h), and allows cities to donate surplus equipment, supplies, or other materials used in fighting fires to the Texas Forest Service or to a successor agency authorized to cooperate in the development of rural fire protection plans (§52g).

##### 2. Texas Constitution Art. 11, §3

- a. This section states in relevant part: “No county, city, or other municipal corporation shall hereafter become a subscriber to the capital of any private corporation or association, or make any appropriation or donation to the same, or in anywise loan its credit; . . . .”
- b. This provision generally prohibits cities from entering into a joint venture or partnerships.

### 3. Secondary Sources

- a. Brooks, 22 Tex. Prac. Series §8.04 (relating to private aid, grants, stockholder prohibitions)
- b. 16 McQuillins Mun. Corp. §28:52 (3d ed.) (discussing the power to transfer, donate, or dedicate property for particular purposes)

### B. Generally

1. **Purpose of Constitutional Restriction Regarding Use of Public Funds.** The purpose of Art. 3, §52 is to prohibit cities and other political subdivisions from making gifts of public funds to any individual, association, or corporation. A corporation includes a municipal corporation such as a city or an independent school district.<sup>1</sup>
2. **Incidental Benefit of a Private Interest.** Art.3, §52 does not invalidate an expenditure that incidentally benefits a private interest if the expenditure is made for the direct accomplishment of a legitimate public purpose.<sup>2</sup>
3. **Three-Part Public Purpose Test**
  - a. **Generally.** The Texas Supreme Court has provided a three-part test to determine if a statute accomplishes a public purpose: “Specifically, the Legislature must: (1) ensure that the statute’s predominate purpose is to accomplish a public purpose, not to benefit private parties; (2) retain public control over the funds to ensure that the public purpose is accomplished and to protect the public’s investment; and (3) ensure that the political subdivision receives a return benefit.”<sup>3</sup> The Attorney General’s Office has identified similar principals for determining whether a particular expenditure serves a public purpose.
  - b. **Economic Development.** A city ensures that the public purpose of economic development will be accomplished by a funded business when the city enters into a contract with the business that: (1) outlines the steps the business will take to justify public funding (for example, creation of jobs or expansion of the tax base by construction or enhancement of the physical facilities); (2) includes a claw back provision that would allow the city to seek reimbursement of the incentives provided if the business does not meet its obligations; and (3) includes a tangible means of measuring whether the business has met its obligations under the contract.<sup>4</sup>
4. **Discretion of Governing Body.** The governmental body must determine in the first instance whether an expenditure of funds or extension of credit serves a legitimate public purpose.<sup>5</sup> Such decisions are within the sound discretion of the governing

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<sup>1</sup> Tex. Att’y Gen. Op. No. GA-0747 (2009) (citing *San Antonio Indep. Sch. Dist. v. Bd. Of Trs. of the San Antonio Elec. & Gas Sys.*, 204 S.W.2d 22, 25 (Tex. Civ. App.—El Paso 1947, writ ref’d n.r.e.)

<sup>2</sup> See *Walker v. City of Georgetown*, 86 S.W.3d 249,260 (Tex. App.—Austin 2002, pet. denied).

<sup>3</sup> *Tex. Mun. League Intergovernmental Risk Pool v. Tex. Workers’ Comp. Comm’n*, 74 S.W.3d 377, 383 (Tex. 2002)

<sup>4</sup> 2015 Economic Development Handbook, *Texas Municipal League*, p. 161.

<sup>5</sup> See Tex. Att’y Gen. Op. No. GA-0747 (2009) (referencing Tex. Att’y Gen. Op. No. GA-0078 (2003) at 4 (citing *Young v. City of Houston*, 756 S.W.2d 813, 814 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1988, writ denied) (determining public

body of a municipality, subject to judicial review. “Texas courts defer to the legislature’s determination of what is a public purpose, since deciding what is a public purpose is primarily a legislative finding.”<sup>6</sup>

### C. Examples

1. **Red Light Camera Citation.** Governmental entities payment of a civil penalty for which the entity is liable would not violate Art. 3, §52.<sup>7</sup>
2. **Employment Contract.** Art. 3, §52 does not prohibit the payment of benefits to an employee pursuant to an employment contract.<sup>8</sup>
3. **Travel Expenses for Job Applicant.** Under certain circumstances, spending public funds to pay the travel expenses of a job candidate may not violate Art. 3, §52.<sup>9</sup>

## II. MUNICIPAL BORROWING<sup>10</sup>

### A. Resources

1. Municipal Law and Procedure Manual, Chapter 17, Municipal Borrowing
2. Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration
3. Municipal Finance 101: Basics Every City Attorney Needs to Know by Karen Brophy, City of Irving and Jeanene McIntyre, City of Arlington  
[http://www2.dallasbar.org/upload/uploads/sections/Brophy\\_McIntyre\\_Definitions%5b1%5d.pdf](http://www2.dallasbar.org/upload/uploads/sections/Brophy_McIntyre_Definitions%5b1%5d.pdf)
4. Commonly Asked Bond Law Questions by Robert R. Collins and Julie Partain, Bracewell (attached)
5. Roles and Responsibilities: The Financing Team in an Initial Municipal Bond Offering  
<http://msrb.org/msrb1/pdfs/Financing-Team.pdf>
6. Municipal Debt Instruments – An Overview by Charles M. Williams, Olson & Olson LLP
  - a. Paper  
[http://www.texascityattorneys.org/2012speakerpapers/FallConference/Municipal\\_Debt\\_Instruments.pdf](http://www.texascityattorneys.org/2012speakerpapers/FallConference/Municipal_Debt_Instruments.pdf)
  - b. Presentation  
[http://www.texascityattorneys.org/2012speakerpapers/FallConference/Municipal\\_Debt\\_Instruments\\_ppt.pdf](http://www.texascityattorneys.org/2012speakerpapers/FallConference/Municipal_Debt_Instruments_ppt.pdf)

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purpose is primarily legislative function); *City of Coleman v. Rhone*, 222 S.W. 646, 649 (Tex. Civ. App. – Eastland 1949, writ ref’d) (determining public purpose of ordinance is for municipal governing body)).

<sup>6</sup> Tex. Att’y Gen. Open Records Decision No. ORD-660 (1999) (citing *Bullock v. Calvert*, 480 S.W.2d 367, 370 (Tex. 1972); *State v. Austin*, 331 S.W.2d 737 (1960); and *Young v. Houston*, 756 S.W.2d 813, 814 (Tex. App.—Houston [1<sup>st</sup> Dist.] 1988, writ denied)).

<sup>7</sup> Tex. Att’y Gen. Op. No. GA-0747 (2009) (regarding whether a school district may expend district funds to pay a civil penalty imposed by a municipality).

<sup>8</sup> Tex. Att’y Gen. Op. No. JC-0115 (1999) (citing Tex. Att’y Gen. Op. No. H-1303 (1978) (other citations omitted)).

<sup>9</sup> Tex. Att’y Gen. Op. No. DM-317 (1995) (discussing whether a county may pay travel expenses of an applicant for the position of county forensic pathologist).

<sup>10</sup> Handbook for Mayors and Councilmembers, Chapter 3, Financial Administration, pp. 3-8—3-11.

7. 2015 Economic Development Handbook, *Texas Municipal League*, [http://tml.org/p/Economic%20Development%20Handbook\\_Revised%209%201%202015.pdf](http://tml.org/p/Economic%20Development%20Handbook_Revised%209%201%202015.pdf)

**B. Bonds, Generally**

**1. Authority**

**a. Constitutional Debt – Tex. Const. Art. 11, §§5 and 7**

- 1) Tex. Const. Art. 11, §§5 and 7 generally require that provision be made to levy and collect a tax of a sufficient sum to pay interest and create a sinking fund of at least two per cent to repay the principal amount of the obligation.
- 2) A sinking fund (also called the “mandatory redemption fund”) is a fund into which moneys are placed to be used to redeem securities in accordance with a redemption schedule in the bond contract.
- 3) Although Art. 11, §5 references “debt” and Art. 11, §7 references “debt for any purpose,” courts have treated these references to debt and its related provisions as equivalent in municipal cases. Art. 11, §7 also applies to counties.
- 4) There are constitutional and statutory limits on a city’s power to tax; therefore, the additional taxes for bonds plus other taxes may not exceed these restrictions.<sup>11</sup>
- 5) 2011 Amendments to Art. 11, §§5 and 7 and Texas Government Code, Chapter 791 authorize cities or counties to enter multi-year Interlocal Agreements without meeting the tax and sinking fund requirements of these sections of the Constitution.

**b. Texas Supreme Court Definition of “Debt”**

- 1) “The term ‘debt’ as used in the constitution means any pecuniary obligation imposed by contract, except such as were, at the date of the contract, within the lawful and reasonable contemplation of the parties, to be satisfied out of the current revenues for the year or out of some fund then within the immediate control of the corporation.” *McNeill v. City of Waco*, 33 S.W. 322, 324 (Tex. 1895).
- 2) Court notes exceptions to the constitutional requirement to levy a tax and establish a sinking fund, if the obligation is payable out of either:
  - a) The current revenues for the year of the contract (also, codified in Texas Local Government Code §271.093); or
  - b) Any other fund within the immediate control of a city.
- 3) Expenditures past the current budget year are “subject to appropriation.”

**c. Tex. Const. Art. 3, §52**

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<sup>11</sup> Municipal Law and Procedure Manual, p. 17-3.

- 1) **Specific Authority.** A city must have specific authority to issue bonds for a specific purpose.<sup>12</sup>
  - 2) **Constitutional Authority.** Authorizes bonds for several purposes:
    - a) Improvements to rivers, creeks, and streams to prevent overflow or to permit irrigation or navigation.
    - b) Construction of paved, graveled or macadamized roads, and turnpikes.
    - c) Construction of ponds, lakes, dams, reservoirs, and canals for the purpose of irrigation, drainage, or navigation.<sup>13</sup>
  - 3) **Legislative Authority.** Legislature has authority to allow cities to issue bonds.
- d. **Municipal Bonds.** Texas Government Code §1331.001 authorizes bonds for the following purposes:
- 1) Construction or purchase of permanent improvements inside the municipal boundaries, including public buildings, waterworks, and sewers.<sup>14</sup>
  - 2) Construction or improvement of streets and bridges of municipality.<sup>15</sup>
  - 3) Construction or purchase of building sites of buildings for the public schools or other institutions of learning inside the municipality, if the municipality has assumed exclusive control over those facilities.<sup>16</sup>
- e. **Authority from Charter.** Tex. Const. Art. 11, §5 and Texas Government Code §1331.052 – a home rule city has the power to issue bonds in the amount and to the extent provided by its charter.

**2. Examples of Additional Statutory Authority**

- a. Texas Local Government Code §280.003 – purchase land to be used for hospital purposes.
- b. Texas Local Government Code §331.004 – acquiring or improving land, buildings, or historically significant objects for park purposes or for historic or prehistoric preservation purposes.
- c. Texas Government Code, Chapter 1502 – purchase, repair, and construction of a utility system, park, or swimming pool.
- d. Texas Government Code, Chapter 1504 – establish, acquire, lease, construct, improve, enlarge, equip, repair, operate or maintain a civic center, auditorium, opera house, music hall, exhibition hall, coliseum,

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<sup>12</sup> Tex. Const. Art. 3, §52

<sup>13</sup> Municipal Law and Procedure Manual, p. 17-2.

<sup>14</sup> Texas Gov't Code, §1331.001(1).

<sup>15</sup> Texas Gov't Code, §1331.001(2).

<sup>16</sup> Texas Gov't Code, §1331.001(3).



museum, library, or other municipal building; or a golf course, tennis court, and other similar recreational facility.

- e. Texas Government Code, Chapter 1507 – payment of a final judgment rendered by a court of competent jurisdiction; the judgment must be against the city or payment of the judgment is the responsibility of the city, requiring the city to pay the plaintiff an amount in cash, and the municipality does not have the money available to pay the amount of the judgment plus the interest and cost and expenses associated with judgment or decree.
- f. Texas Government Code, Chapter 1508 – construct, purchase, or encumber a park, swimming pool, golf course, golf course clubhouse, or ballpark; a fairground or an exposition building; an airport; or land on which such a facility is located.
- g. Texas Transportation Code §22.052 – planning, acquiring, establishing, constructing, improving, or equipping an airport or air navigation facility or the site of an air navigation facility or acquiring or eliminating airport hazards.

### C. **General Obligation Debt**<sup>17</sup>

- 1. General obligation debts are payable from and secured by a pledge of future property tax collections, and are often expressed as a percentage of the city's total assessed valuations.<sup>18</sup>
- 2. Three common forms: General Obligation (G.O.) Bonds, Time Warrants, Certificates of Obligation
  - a. *General Obligation (G.O.) Bonds* (also called ad valorem tax bonds)<sup>19</sup>
    - 1) Long-term financing tool
    - 2) Authorized by voters at a municipal bond election
    - 3) Backed by ad valorem taxes (often referred to as “the full faith and credit of the city”)
    - 4) Issued pursuant to an ordinance adopted by the city council
    - 5) The Attorney General examines them as to legality, then the city delivers the bond to the successful purchaser/bidder for payment in cash
    - 6) Usually issued in \$5,000 denominations
    - 7) Usually provides serial maturities with a certain amount of principle maturing each year over a period not to exceed 40 years
    - 8) The preferred means of borrowing against a pledge of tax revenues
      - a) Have the highest degree of investor acceptance
      - b) Command the lowest interest rates

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<sup>17</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 48.

<sup>18</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 48.

<sup>19</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 48.

- 9) Used by city to pay for public facilities
- b. *Time Warrants*<sup>20</sup>
  - 1) Do not require voter approval, but
    - a) The law requires that the city council must publish notice of its intent to issue them
    - b) City council must call a referendum election if **10%** of taxpaying voters sign a petition requesting it
  - 2) Payable from ad valorem taxes
  - 3) Issued directly to vendors to pay for construction, equipment, and services
  - 4) Procedures are cumbersome and expensive, and results in the city paying a higher rate of interest
  - 5) Still potentially advantageous if there is a project where there has been a cost overrun and bond funds have been exhausted
- c. *Certificates of Obligation (COs)*<sup>21</sup>
  - 1) Statute: Texas Local Government Code, Chapter 271
  - 2) Only the following types of cities may issue COs:
    - a) A home rule city (regardless of a charter provision that provides otherwise); or
    - b) A general law city authorized to levy ad valorem taxes of not less than \$1.50 on each \$100 valuation of taxable property.<sup>22</sup>
  - 3) COs can be issued to pay a contractual obligation for:
    - a) Construction of any public work;
    - b) Purchase of materials, supplies, equipment, machinery, buildings, land, and rights-of-way for authorized needs and purposes;
    - c) Payment for professional services (tax appraisers, engineers, architects, attorneys, map makers, auditors, financial advisors, and fiscal agents);<sup>23</sup>
    - d) Construction or equipping a jail;<sup>24</sup>
    - e) Demolishing dangerous structures or restoring historic structures.<sup>25</sup>
  - 4) A city council must authorize COs by ordinance; the certificates may not mature over a period greater than 40 years; and the certificates

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<sup>20</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 48.

<sup>21</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 48.

<sup>22</sup> Tex. Local Gov't Code, §271.044.

<sup>23</sup> Tex. Local Gov't Code, §271.045.

<sup>24</sup> Tex. Local Gov't Code, §271.046.

<sup>25</sup> Tex. Local Gov't Code, §271.0461.

may not bear interest greater than the “net effective interest rate” of 15%.<sup>26</sup>

- 5) COs do not require voter authorization, except that upon notice of the city’s intent to issue certificates, if the city secretary receives a petition signed by **5%** or more of the qualified voters in the city, then an election on the issue, similar to a bond election, must be held.
- 6) COs can be issued directly to vendors, or can be sold for cash (like bonds) in certain circumstances, in which case, the attorney general must approve them in the same manner as bonds.<sup>27</sup>

**D. Revenue Bonds<sup>28</sup>**

1. Unlike G.O. bonds, revenue bonds do not require voter approval unless required by municipal charter.
2. They are secured by a pledge of revenues from an income-producing facility, often a utility system, such as a water and sewer system, and the bonds are commonly designated with the name of the utility system that pledges the revenue.
3. The utility system revenue bonds are payable solely from the system’s net revenues, which are the gross revenues minus operating and maintenance costs.
4. The bonds include a statement on their face that the holder shall never be entitled to demand payment from property taxes. In other words, revenue bonds are not backed by the full faith and credit of the city.

**E. Lease-Purchase Agreements<sup>29</sup>**

1. This is a contract entered into between the “lessee” city and the “lessor” which can be either a vendor of personal property or a financing company.
2. The city obtains the use of personal property, typically equipment or vehicles, over a period of time that is generally between 3 and 15 years.
3. The term of the agreement is generally matched to the useful life of the asset.
4. Title passes to the city at the beginning of the lease, and at the end of the lease the city completes the purchase for a nominal fee.
5. This arrangement is not considered “debt” and therefore not subject to the Texas Constitution’s restrictions because the lease does not obligate the city beyond the current fiscal period. The lease should contain a non-appropriation clause allowing the city to terminate the lease at the end of each budget year if the city has not appropriated lease funds.

**F. Other Types of Indebtedness**

1. **Anticipation notes** – issued to borrow against anticipated revenue—typically federal grant money.<sup>30</sup>

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<sup>26</sup> Tex. Local Gov’t Code, §271.047; Texas Gov’t Code, §1204.006.

<sup>27</sup> Tex. Local Gov’t Code, §271.050.

<sup>28</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 49.

<sup>29</sup> See Tex. Local Gov’t Code, §271.005.

<sup>30</sup> Handbook for Mayors and Councilmembers, Chapter 6, Financial Administration, p. 50.

- a. Appropriate to borrow relatively small amounts of money when the issuance of bonds would be cost prohibitive.
  - b. See Texas Government Code Ch. 1431.
2. **Judgment bonds**
- a. Bonds issued to pay final judgments and court-approved settlements when the issuer is unable to pay the judgment from other funds.
  - b. See Texas Government Code, Chapter 1507.
3. **Tax note** – tool for alleviating short-term cash flow needs.<sup>31</sup>
- a. Paid from tax revenue received in the following fiscal years.
  - b. Can be used to pay for public improvements.
4. **Refunding bonds** – tool for refinancing short-term or long-term debt.<sup>32</sup>
- a. Documentation similar to that of COs but no publication of notice is required.
  - b. Often used to consolidate several short-term notes.
  - c. No election required.

**G. Role of the Attorney General**

- 1. Prior to issuance of a public security, the issuer shall submit the public security and the record of authorization proceedings to the attorney general for review and approval.<sup>33</sup>
  - a. Public securities are defined to include certain instruments, including bonds, notes, certificates of obligation, certificates of participation, or other instruments evidencing a proportionate interest in payment due by an issuer that are incurred under the issuer’s borrowing power and are in the appropriate form.<sup>34</sup>
  - b. Certain time warrants, leases, lease-purchase agreements, installment sale contracts, and bonds that are payable only from current revenues or taxes collected in the year of issuance are excepted from the approval requirement. Each of these obligations, however, may be required to receive approval under other law.<sup>35</sup>
- 2. A public security cannot be issued if it is not approved by the attorney general.
- 3. After the public security is approved by the attorney general, registered by the comptroller, and issued, it is incontestable, except for claim of unconstitutionality.<sup>36</sup>

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<sup>31</sup> Tex. Gov’t Code, §1202.003.

<sup>32</sup> Tex. Gov’t Code, §1202.003.

<sup>33</sup> Tex. Gov’t Code, §1202.003(a) (a); see also §1202.001(3) (providing a definition of “public security”) and §1202.007 (providing exceptions).

<sup>34</sup> 2013 Economic Development Handbook, Office of the Attorney General, p. 177 (referencing Tex. Gov’t Code §1202.001(3)).

<sup>35</sup> 2013 Economic Development Handbook, Office of the Attorney General, p. 177 (referencing Tex. Gov’t Code §1202.007).

<sup>36</sup> Tex. Gov’t Code, §1202.003.

## H. Recent legislation

### 1. 2013 Legislation – Bond Elections

- a. S.B. 637 relates to notice and election order requirements for bond approval elections held by political subdivisions.
- b. S.B. 637 added Section 3.009 and amended Section 4.003 of the Texas Election Code:
  - 1) Section 3.009 requires additional information in a debt obligation election order
  - 2) Section 4.003(f) requires posting of the debt obligation election order:
    - a) At each polling location
    - b) In three public places in the municipality
    - c) On municipality's Internet website, if the municipality maintains a website

### 2. 2015 Legislation

#### a. Local Debt Reporting – H.B. 1378

- 1) Every political subdivision must annually compile and report certain financial information, including debt obligation information, the current credit rating, and any other information relevant or necessary to explain the values.
- 2) A political subdivision may provide a link in the report to information that is posted separately on the political subdivision's website.
- 3) As an alternative to preparing a report, a political subdivision may provide all required debt information to the comptroller and have the comptroller post the information on the comptroller's website.
- 4) As an alternative to preparing a report, a city with a population under 15,000 may provide to the comptroller a document that contains the required debt information.
- 5) The annual report must be available for inspection and posted on the political subdivision's website. The contact information for the political subdivision's main office must also be continuously posted on its website.

#### b. Certificates of Obligation (C.O.) – H.B. 1378

- 1) A city may not issue a C.O. if the voters voted down a bond proposition for the same purpose within the past three years.
- 2) This does not apply to a case of public calamity, a case in which the issuer needs to act to protect the health of residents, a case of unforeseen damage to public equipment or property, or comply with state or federal regulation.

- c. **Capital Appreciation Bonds – H.B. 114.** Establishes new requirements for a city to issue capital appreciation bonds that are secured by property taxes.

These requirements do not apply to refunding bonds or capital appreciation bonds for transportation projects.

I. **84<sup>th</sup> Texas Legislature Interim Charges (2015)**

1. **Senate Committee on Intergovernmental Relations:** Examine ways to improve government accountability in elections regarding issuance of public debt. Include a review of the information that is currently provided to individuals in the voting booth and provide statutory recommendations, if necessary, to improve transparency.
2. **House Committee on Elections:** Evaluate options to improve the transparency of local bond elections, including but not limited to: current processes used to educate voters about how tax dollars will be spent, the time of year bond elections are held, and the description of bond proposals on the ballot. Make appropriate legislative recommendations.
3. **Resources**
  - a. TML Legislative Update, Number 41, December 4, 2015 (Interim Hearings Begin: Cities on the Agenda)  
[http://tml.org/legis\\_updates/interim-hearings-begin-cities-on-the-agenda](http://tml.org/legis_updates/interim-hearings-begin-cities-on-the-agenda)
  - b. TML Legislative Update, Number 38, November 6, 2015 (Speaker Straus Releases House Interim Charges)  
[http://tml.org/legis\\_updates/speaker-straus-releases-house-interim-charges](http://tml.org/legis_updates/speaker-straus-releases-house-interim-charges)
  - c. TML Legislative Update, Number 36, October 16, 2015 (Lieutenant Governor Releases Senate Interim Charges: Numerous City Related Issues)  
[http://tml.org/legis\\_updates/lsgov-releases-senate-interim-charges-numerous-city-related-issues](http://tml.org/legis_updates/lsgov-releases-senate-interim-charges-numerous-city-related-issues)

III. **MUNICIPAL DEPOSITORIES**

A. **Statutes**

1. Local Government Code, Chapters 105 and 131
2. Government Code, Chapter 2257

B. **Resources**

1. Sample Depository Agreement:  
[http://www.tml.org/legal\\_pdf/depository\\_agreement.pdf](http://www.tml.org/legal_pdf/depository_agreement.pdf)
2. Sample Depository Request for Proposals:  
[http://www.tml.org/legal\\_pdf/Depository\\_RFP.pdf](http://www.tml.org/legal_pdf/Depository_RFP.pdf)
3. Municipal Law and Procedure Manual, Chapter 15, Depositories and Investments.

- C. **Requirement.** The city council shall designate the bank, credit union, or savings association that will serve as the depository for the municipality's funds.<sup>37</sup>

D. **Process**

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<sup>37</sup> Tex. Local Gov't Code, §105.016(a).

1. **Designated officer.** The city council shall designate the treasurer of the municipality or another officer as the “designated officer.”<sup>38</sup>
2. **Adopt written policy [Optional].** If the city council desires to consider institutions not doing business within the city, then the city council must adopt a written policy specifically allowing the consideration of applications received by institutions not doing business within the city, after taking into consideration what is in the best interest of the city.<sup>39</sup>
3. **Notice.** The designated officer must give notice to banks, credit unions, or savings associations requesting the submission of applications for depository services, and notice must include:
  - a. The name and address of the designated officer receiving the applications;
  - b. The date and time the applications are to be received by the designated officer; and
  - c. The date, time, and place the city council will consider the selection of one or more depositories.<sup>40</sup>
4. **Receipt of application.** A financial institution must deliver its application on or before the date specified in the notice. The designated officer may not consider any application received after the date and time on the notice for receiving applications.<sup>41</sup>
5. **Review.** The designated officer reviews the applications and evaluates the terms and conditions for performance, such as the type and costs of service, consistent with any policy guidelines adopted by city council.<sup>42</sup>
6. **Specifications.** The designated officer presents the specifications of each application to city council.
7. **Selection and designation.** The city council may authorize the execution of one or more contracts, may reject any and all of the applications, and readvertise if all applications are rejected.<sup>43</sup> The city council shall designate, by order recorded in its minutes, the financial institution to serve as the depository for municipal funds.<sup>44</sup>
8. **Deadline for security.** The financial institution selected by the city council must, not later than five days before the commencement of the term of the depository services contract, provide security for the municipal funds which will be deposited pursuant to the depository services contract.<sup>45</sup> If the financial institution fails to meet this deadline, the selection of such financial institution is void.

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<sup>38</sup> Tex. Local Gov’t Code, §105.001(8).

<sup>39</sup> Tex. Local Gov’t Code, §105.011; *see also* Municipal Law and Procedure Manual, p. 15-3.

<sup>40</sup> Tex. Local Gov’t Code, §105.012(b).

<sup>41</sup> Tex. Local Gov’t Code, §105.013.

<sup>42</sup> Tex. Local Gov’t Code, §105.014.

<sup>43</sup> Tex. Local Gov’t Code, §105.015.

<sup>44</sup> Tex. Local Gov’t Code, §105.016.

<sup>45</sup> Tex. Local Gov’t Code, §§105.016(b) and 105.031.

## 9. Security

- a. Chapter 2257 of the Texas Government Code provides the requirements for the security, namely, the type, level, substitution, possession, release, and method of valuation of the security needed.<sup>46</sup>
- b. A surety bond may qualify as security if:
  - 1) Executed by one or more solvent surety companies authorized to do business in Texas;
  - 2) Is payable to the municipality; and
  - 3) Has been approved by the city council.<sup>47</sup>
- c. Since Chapter 2257 trumps any other law relating to security for deposit of public funds in case of a conflict, ensure that the bond meets all the requirements of Local Government Code, §105.033.

## 10. Deposit of funds

- a. The designated officer shall transfer to financial institution all municipal funds covered by the depository services contract **within 60 days** of city council's designation of the depository.<sup>48</sup>
- b. As soon as practicable, the designated officer shall deposit any money covered by the contract received after the depository is designated.<sup>49</sup>

### E. Institutions Not Located Within City

1. A city may not select a financial institution located outside of Texas.<sup>50</sup>
2. The city council can consider the application of a bank, credit union, or savings association that is not located in the municipality if:
  - a. The financial institution:
    - 1) Maintains a branch office in Texas; and
    - 2) Offers within Texas the services required by the depository services contract; and
  - b. The city council, prior to giving notice requesting submission of applications for depository, has adopted a written policy specifically allowing the consideration of applications received by institutions not doing business within the city, after taking into consideration what is in the best interest of the city.<sup>51</sup>

### F. Depository Services Agreement

1. **Requirements.** The municipality should enter into a depository contract including the following statutorily required conditions:

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<sup>46</sup> Tex. Local Gov't Code, §105.031.

<sup>47</sup> Tex. Local Gov't Code, §105.033.

<sup>48</sup> Tex. Local Gov't Code, §105.073.

<sup>49</sup> Tex. Local Gov't Code, §105.073.

<sup>50</sup> Tex. Local Gov't Code, §131.901; *see also* Municipal Law and Procedure Manual, p. 15-3.

<sup>51</sup> Tex. Local Gov't Code, §105.011; *see also* Municipal Law and Procedure Manual, p. 15-3.



- a. Keep the municipal funds covered by the depository services contract<sup>52</sup>
  - b. Perform all duties and obligations imposed on the depository by law and under the depository services contract<sup>53</sup>
  - c. Pay on presentation all checks drawn and properly payable on a demand deposit account with the depository<sup>54</sup>
  - d. Pay all transfers properly payable as directed by a designated officer<sup>55</sup>
  - e. Provide and maintain security at an amount not less than the amount of the deposit of public funds, increased by the amount of any accrued interest, and reduced to the extent that the United States or an instrumentality of the United States insures the deposit <sup>56</sup>
  - f. Account for the municipal funds as required by law<sup>57</sup>
  - g. Relating to the possession, substitution, or release of security, which includes:
    - 1) Requiring the depository to execute a new bond or pledge additional securities for the deposit of municipal funds;<sup>58</sup>
    - 2) Substituting one security for another;
    - 3) Releasing securities pledged by a depository in excess of the amount required by Chapter 105, Texas Local Government Code;
    - 4) The time period in which such addition, substitution, or release of security by a depository may occur; and
    - 5) Any other matters relating to the possession, substitution, or release of security the municipality considers necessary for its protection.<sup>59</sup>
2. **Selection of new depository.** If the depository fails for any reason to comply with these requirements, then the city council may select a new depository using the same procedures as before.<sup>60</sup>
  3. **Venue.** By statute, any suit relating to a depository services contract must be tried in the county where the city hall of the municipality is located.<sup>61</sup> Therefore, be sure to include this language in the venue provision of the depository services contract.

## G. Payment of Funds<sup>62</sup>

### 1. Generally

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<sup>52</sup> Tex. Local Gov't Code, §105.034(a)(1).

<sup>53</sup> Tex. Local Gov't Code, §105.034(a)(2).

<sup>54</sup> Tex. Local Gov't Code, §105.034(a)(3).

<sup>55</sup> Tex. Local Gov't Code, §105.034(a)(4).

<sup>56</sup> Tex. Local Gov't Code, §105.034(a)(5); Gov't Code, ch. 2257.022.

<sup>57</sup> Tex. Local Gov't Code, §105.034(a)(6).

<sup>58</sup> Tex. Local Gov't Code, §105.051(a)(1).

<sup>59</sup> Tex. Local Gov't Code, §105.051(a)(2-5).

<sup>60</sup> Tex. Local Gov't Code, §105.051(b).

<sup>61</sup> Tex. Local Gov't Code, §105.034(b).

<sup>62</sup> Municipal Law and Procedure Manual, p. 15-6 – 15-8.

- a. A municipality's funds may be paid out of the depository only at the direction of a designated officer.<sup>63</sup>
  - b. The designated officer may draw a check on a depository only on a warrant signed by the mayor and attested by the municipal clerk,<sup>64</sup> unless the city council adopts procedures as provided below.
  - c. If there is sufficient money in a fund in a depository, a warrant can be drawn on that fund by the designated officer.<sup>65</sup>
  - d. In order to draw a check on any funds designated in the depository services agreement, a designated officer must adhere to all notice requirements according to the terms of the contract with the depository.<sup>66</sup>
  - e. The mayor and city secretary may not draw a warrant on a special fund in a depository or under the control of the designated officer that was created to pay the bonded indebtedness of the municipality other than to pay the principal of or interest on the indebtedness or to invest the fund as provided by law.<sup>67</sup>
  - f. The designated officer may not pay or draw a check to pay money out of a special fund that was created to pay the bonded indebtedness of the municipality other than to pay the principal of or interest on the indebtedness or to invest the fund as provided by law.<sup>68</sup>
2. Notwithstanding the provisions listed above, the city council may adopt procedures:
    - a. Governing the method by which the designated officer is authorized to direct payments from the funds of the municipality on deposit with a depository;<sup>69</sup>
    - b. Governing the method of payment of obligations of the municipality, including payment by check, draft, wire transfer, or other method of payment mutually acceptable to the municipality and the depository; and<sup>70</sup>
    - c. The governing body determines are necessary to ensure the safety and integrity of the payment process.<sup>71</sup>
  3. If a municipality adopts any such procedures, a copy shall be filed with the depository. Further, the designated officer and the depository shall agree upon record-keeping safeguards and other measures necessary to ensure the safety and integrity of the payment process.<sup>72</sup> These safeguards must be approved by the city

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<sup>63</sup> Tex. Local Gov't Code, §105.074(a).

<sup>64</sup> Tex. Local Gov't Code, §105.074(b).

<sup>65</sup> Tex. Local Gov't Code, §105.074(c).

<sup>66</sup> Tex. Local Gov't Code, §105.074(d).

<sup>67</sup> Tex. Local Gov't Code, §105.074(e).

<sup>68</sup> Tex. Local Gov't Code, §105.074(f).

<sup>69</sup> Tex. Local Gov't Code, §105.074(g).

<sup>70</sup> Tex. Local Gov't Code, §105.074(g).

<sup>71</sup> Tex. Local Gov't Code, §105.074(g).

<sup>72</sup> Tex. Local Gov't Code, section 105.074(h).

council if they are consistent with and do not contravene the procedures already adopted.<sup>73</sup>

- H. **Conflicts of Interest.** Absent a home rule charter that states otherwise, the following relationships do not disqualify a financial institution from serving as a municipal depository:
1. A municipal officer or employee who does not have the duty to select the depository is an officer, director or shareholder of the bank;
  2. One or more officers or employees of the city who have a duty to select the depository are officers or directors of the financial institution or own or have a beneficial interest, individually or collectively, in 10% or less of the outstanding capital stock of the bank, if:
    - a. The majority of remaining members of the board, committee, or other body of the municipality vote to select the bank as the depository; and
    - b. The interested officer or employee does not vote or take part in the proceedings.<sup>74</sup>
- I. **Special Depository.** If a municipal depository suspends business or is taken charge of by a state or federal bank regulatory agency, the city council may select by contract a special depository for the funds in the suspended financial institution.<sup>75</sup> Chapter 131, Texas Local Government Code provides duties of the special depository<sup>76</sup> and requirements for the special depository contract<sup>77</sup> and bond(s).<sup>78</sup> Finally, a city may pursue legal remedies against a suspended bank when it determines that it is in the best interest of the public.<sup>79</sup>

#### IV. MUNICIPAL INVESTMENTS

##### A. Authority

###### 1. Constitution

- a. **Texas Constitution Art. 3, §52(e).** This provision states, “A county, city, town, or other political corporation or subdivision of the state may invest its funds as authorized by law.”
- b. **Texas Constitution Art. 11, §3.** This provision authorizes a county, city, or other municipal corporation from investing its funds as authorized by law.

###### 2. Statute. Public Funds Investment Act (“PFIA”): Chapter 2256, Texas Government Code

##### B. Resources

1. Municipal Law and Procedure Manual, Chapter 15, Municipal Depositories and Investments.
2. Government Treasurers’ Organization of Texas – Investment Policy Certification Program – Investment Policy Certification Checklist

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<sup>73</sup> Tex. Local Gov’t Code, section 105.074(h).

<sup>74</sup> Tex. Local Gov’t Code, §131.903.

<sup>75</sup> Tex. Local Gov’t Code, §131.001, Municipal Law and Procedure Manual, p. 15-3.

<sup>76</sup> Tex. Local Gov’t Code, §131.002.

<sup>77</sup> Tex. Local Gov’t Code, §131.003.

<sup>78</sup> Tex. Local Gov’t Code, §131.004.

<sup>79</sup> Tex. Local Gov’t Code, §131.902.

<http://gtot.unt.edu/content/investment-policy-certification-program> (Under Attachments, click on "Checklist.doc")

3. 2011 Legislative Revisions (HB 2226)
  - a. UNT Center for Public Management Resource:  
<http://pacs.unt.edu/cpm/sites/default/files/2011%20PFIA%20Legislative%20Changes.pdf>
  - b. City of Irving Investment Policy (the underlined items in the policy reflect revisions due to the 2011 Legislative revisions):  
<http://texascityattorneys.org/wp-content/uploads/2013/06/FinancePresentationHandout-CityofIrvingInvestmentPolicy2012Handout.pdf>

C. **Compliance Required.** A city must comply with the PFIA in order to invest public funds.

D. **PFIA Requirements.** The PFIA requires a city to do the following before it invests its public funds:

1. **Written investment policy.** City council must adopt a written investment policy by ordinance or resolution. The written policy must contain a statement emphasizing safety and liquidity.
  - a. Regardless of its size, a city must have a written policy if it has any cash or bank investments.
  - b. The city council must review the policy at least once a year and take formal action regarding such review, including documenting any revisions to the policy.
2. **List of authorized investments.** Policy must include a list of authorized investments that comply with the PFIA. The policy must also include a list of authorized investments and the permitted maximum maturity of any individual investment, as well as the maximum weighted average maturity (WAM) of funds. The policy must include the method used by the investing entity to monitor the market price of acquired investments.
3. **Invest in authorized investments.** Only invest its funds in investments authorized by its written investment policy.
4. **Training.** A city official must complete training relating to the PFIA. The treasurer, the chief financial officer [if she is not the treasurer], and the investment officer must attend at least one training session relating to their responsibilities pursuant to PFIA within twelve months of taking office, and must continue to do so at least once every two fiscal years.
  - a. **Recent legislation**
    - 1) H.B. 870 – reduces the amount of training hours from ten hours every two years to eight hours every two years.
    - 2) H.B. 1148 – A city investment officer must take only the initial 10 hour training under the PFIA but no continuing investment training if the city: (a) does not invest funds; (2) or only deposits city funds in interest-bearing deposit accounts or certificates of deposit.

- E. **No Stocks.** Cities may not invest in corporate stocks, also called equities.
- F. **Penalty for Noncompliance.** Although no penalty provision, credit agencies and auditors are aware of the requirements of the PFIA, and failure to follow it, may impact credit ratings or it may result in negative comments in an audit.