

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

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# Resources

- ***Handbook for Mayors and Councilmembers (2017)***  
<https://www.tml.org/p/2017handbookmayorscouncilmembers.pdf>
- ***TML Revenue Manual for Texas Cities (2017)***  
<https://www.tml.org/p/2017revenuemanual.pdf>
- ***Texas Municipal Law and Procedure Manual***  
<https://municlerks.unt.edu/publications/mlawman.html>
- ***Municipal Finance: The Public Purpose Doctrine and the Basics of Borrowing, Depositories, and Investments***

# Overview

1. Public Purpose Doctrine
2. Municipal Borrowing
3. Municipal Depositories
4. Municipal Investments

# Public Purpose Doctrine: Applicable Law

- Texas Constitution Art. 3, §52
  - “[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. . . .”
- Texas Constitution Art. 11, §3
  - “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; . . .”

# Public Purpose Doctrine: Overview

- Purpose of Constitutional Restrictions
- Incidental Benefit of a Private Interest
- Three-Part Public Purpose Test
  1. Predominate purpose
  2. Public control over funds
  3. Political subdivision receives a return benefit
- Legislative Determination
- Examples

# Public Purpose Doctrine: Economic Development

- Texas Constitution Art. 3, §52-a
  - Economic development is a public purpose
  - Local Government Code, Chapter 380
- Three-Part Public Purpose Test
  1. Outline steps business will take to justify public funding
  2. Claw back provision if obligations not met
  3. Tangible means of measuring whether business has met obligations

# Municipal Borrowing: Authority

- Texas Constitution Art. 11, § 5 and 7
  - Generally, levy and collect tax to pay interest and create a sinking fund of at least two per cent (2 %) to repay principal
    - A “sinking fund” is a fund into which moneys are placed to be used to redeem securities in accordance with a redemption schedule in a bond contract.
  - Remember, constitutional and statutory limits on a city’s power to tax; additional taxes for bonds plus other taxes may not exceed these restrictions
  - Since 2011, cities and counties may enter into multi-year Interlocal Agreements without meeting tax and sinking fund requirements of Art. 11, § 5 and 7

# Municipal Borrowing: Authority

- Texas Constitution Art. 3, § 52
  - City must have specific authority to issue bonds for a specific purpose
  - Legislature has authority to allow cities to issue bonds
- Texas Supreme Court: *McNeill v. City of Waco*
  - Defines “debt”
  - Exceptions:
    1. Current revenue (Local Gov’t Code § 271.903)
    2. Special funds



# Municipal Borrowing: Authority

- Authority derived from:
  - Constitution
  - Statutes
    - Texas Government Code §1331.052
      - General authority for home rule cities
      - Permanent public improvements
      - Other public purposes authorized by charter and consistent with constitution
    - Additional Statutory Authority
  - Home Rule Charter

# Municipal Borrowing: Bonds

- Definition: A promise by a local government (issuer) to lenders of money (investors) to repay that money (principal) along with interest, by a certain date (maturity)

# Types of Debt: General Obligation Debt

- **General Obligation Bonds**
  - Statute: Texas Government Code, § 1331.052
  - Backed by ad valorem taxes
  - Authorized by municipal bond election
  - Used for permanent public improvements and other public purposes as provided by statute and city charter
- **Certificates of Obligation (C.O.)**
  - Statute: Texas Local Government Code, Ch. 271
  - Supported by ad valorem taxes, revenues or both
  - Election is *not* required (unless a petition is received)
  - May be used to pay for: public improvements, professional services, demolition of substandard structure, restoration of historic structures
- **Time Warrants**

# Types of Debt: Revenue Bonds

- Authority from various statutes according to the type of project
- Not secured by a pledge of property taxes
- No bond election required (unless city charter requires)
- Revenue stream is pledged to finance a revenue-producing asset

# Other Types of Debt

## ■ Refunding Bonds

- **Statute:** Texas Government Code, Ch. 1207
- A pledge of ad valorem taxes, revenue or both unless limited by applicable statute
- Bond election is **not** required
- May be used to refinance short-term or long-term debt, or other obligation
- **According to federal Tax Cuts and Jobs Act, governmental issuers are unable to issue tax-exempt advance refunding bonds beginning January 1, 2018.**

## ■ Judgment Bonds

- **Statute:** Texas Government Code, §1507.001
- Bond election is required
  - Pursuant to Texas Government Code, Ch. 1207, can refund an obligation to pay pursuant to a court judgment without an election.
- Issued to pay final judgments against a city if money is not available to pay the judgment

# Other Types of Debt

- **Lease-Purchase Agreements**
  - **Statute:** Texas Local Government Code, § 271.005
  - Used to finance the purchase of personal property
- **Anticipation Notes**
  - **Statute:** Texas Government Code, Ch. 1431
  - Issued to borrow against anticipated revenue, typically federal grant money
- **Tax Note**
  - **Statute:** Texas Government Code, §1202.003
  - Tool for alleviating short-term cash flow needs

# Municipal Borrowing: Role of Attorney General

- **Statute:** Texas Government Code, Chapter 1202
- **Generally**
  - Submission of the public security and the record of authorization proceedings to the Attorney General for review and approval
  - A public security cannot be issued if it is not approved by the Attorney General
  - After approval, registration by the comptroller, and issuance, public security is incontestable, except for claim of unconstitutionality

# Municipal Borrowing: Other Roles

- **Bond Counsel** – prepares documents, submits the bonds to the Attorney General for approval, ensures compliance with state and federal law; provides a bond opinion regarding validity and tax-exemption
- **Financial Advisor** – works with the issuer to structure bond financing; works with the Underwriters to price and sell the bonds; assists issuer in preparation of Official Statement; fiduciary obligation to the city
- **Underwriters** – purchase all of an issuer's bonds and resells the bonds in the market to investors
- **Finance Director** – understands financial restraints of city and debt capacity (ability to sell debt and cover debt service within tax or revenue constraints); tracks bond election authority and bond proceeds expenditures; budgets adequate interest and sinking fund to pay debt service
- **City Attorney** – addresses traditional municipal legal issues at outset (charter provisions, competitive bidding, contracts); identifies legal issues during the life of bonds (use of proceeds, use of facilities)



# Municipal Borrowing: Bond Proceeds

- Bond proceeds can only be spent for the purposes for which they were issued:
  - Capital expenditures
  - Election proposition restrictions
  - Purpose clauses
- Expenditures must be tracked for continuing compliance with federal tax law

# Municipal Borrowing: 2013 Legislation

- **Bond Election Orders**
  - **Legislation: S.B. 637 (effective September 1, 2013)**
  - **New requirements**
    - Additional information in debt obligation election order
    - Posting of debt obligation election order:
      - At each polling location
      - In three public places in the municipality
      - On municipality's Internet website, if municipality maintains a website

# Municipal Borrowing: 2015 Legislation

- **Local Debt Reporting**
  - **Legislation: H.B. 1378 (effective January 1, 2016)**
  - **New requirements**
    - Annually compile and report certain financial information
    - May provide a link to separately posted information
    - Alternates to preparing a report
    - Annual report be available for inspection and posted on website

# Municipal Borrowing: 2015 Legislation

- **C.O.'s**
  - **Legislation: H.B. 1378 (effective January 1, 2016)**
  - City may not issue C.O. if voters voted down bond proposition for the same purpose within the past three years
  - Exceptions: for public calamity, to protect public health, for unforeseen damage to public equipment/property, or to comply with state or federal law
- **Capital Appreciation Bonds**
  - **Legislation: H.B. 114 (effective September 1, 2015)**
  - 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.

# Municipal Borrowing: 2017 Legislation

- **Capital Appreciation Bonds**
  - **Legislation: S.B. 295 (effective September 1, 2017)**
  - Cleans up drafting error in H.B. 114
  - Provides that refunding bonds and capital appreciation bonds issued for transportation projects are exempt from the restrictions in all of §1201.0245, Texas Gov't Code.

# Municipal Borrowing: 2017 Interim Charges

- **Senate Committee on Intergovernmental Relations**
  - **Special Purpose Districts Bond Reform:** Study the state agency review of tax exempt bonds issued by special purpose districts and public improvement districts used to finance water and sewer infrastructure in new residential and commercial developments. Examine the disparities that exist between the feasibility review of water and sewer bonds backed by property-based assessments and those backed by ad valorem taxes, and make recommendations that ensure stability of the Texas tax-exempt bond market by requiring all districts to undergo appropriate reviews prior to issuance.
  
- **House Committee on Elections**
  - Study the efficacy of existing transportation finance mechanisms from state, regional, and local perspectives. Identify opportunities to improve existing transportation finance mechanisms and investigate the feasibility of developing new ones.

# Common Bond Law Questions

- Can you use bond proceeds to pay for employee salaries?
- Can a City lease a bond-financed facility to a private entity or hire a private entity to run a city operation?
- What can we do with leftover bond proceeds from an old issue?
- What is a “Parameters Ordinance”?

# Municipal Depositories

## ■ Statutes

- Local Gov't Code, Chapters 105 and 131
- Gov't Code, Chapter 2257

## ■ Resources (tml.org)

- Sample Depository Services Agreement  
([http://www.tml.org/legal\\_pdf/depository\\_agreement.pdf](http://www.tml.org/legal_pdf/depository_agreement.pdf))
- Sample RFP for Banking Services  
([http://www.tml.org/legal\\_pdf/Depository\\_RFP.pdf](http://www.tml.org/legal_pdf/Depository_RFP.pdf))



# Municipal Depositories: Requirements

- City Council must designate bank, credit union, or savings association that will serve as the depository for municipal funds
- Designated officer
- Institutions not located in city
- Depository services agreement
- Special depository

# Municipal Depositories: Conflicts of Interest

- Statute: Texas Local Government Code §131.903
- 10% Rule: A city may **not** select a depository if:
  - one or more municipal officers or employees who have a duty to select the depository own or have a beneficial interest, individually or collectively, in more than 10% of the outstanding capital stock of the bank
- Home-rule charter provision may supersede
- Contrast with Local Gov't Code, Chapter 171

# Municipal Investments

- **Statute:** Public Funds Investment Act (“PFIA”) (Gov’t Code, Chapter 2256)
- **Resources:**
  - UNT Center for Public Management document relating to HB 2226 (2011) (<http://pacs.unt.edu/cpm/sites/default/files/2011%20PFIA%20Legislative%20Changes.pdf>)
  - Example Policy (<http://texascityattorneys.org/wp-content/uploads/2013/06/MunicipalFinancePaper2-24-12-Read-Only-Handout.pdf>)
  - Government Treasurers’ Organization of Texas – Investment Policy Certification Program Checklist (<http://gtot.unt.edu/content/investment-policy-certification-program>) (Under Attachments, click on “Checklist.doc”)

# Municipal Investments: Requirements

- City must comply with Public Funds Investment Act (PFIA) to invest public funds
- PFIA:
  - Written investment policy
  - Include list of authorized investments
  - Only invest in authorized list
  - City official must complete training regarding PFIA
- No penalty provision, but may impact credit ratings or result in negative comments in an audit

# Municipal Investments: 2015 Legislation

- **H.B. 870 (effective September 1, 2015)**
  - Reduces the amount of training hours from ten hours every two years to eight hours every two years.
- **H.B. 1148 (effective September 1, 2015)**
  - A city investment officer must take only the initial 10 hour training but no continuing investment training if the city:
    - Does not invest funds; or
    - Only deposits city funds in interest bearing deposit accounts or certificates of deposit

# Municipal Investments: 2017 Legislation

- **H.B. 1003 (effective June 14, 2017)**
  - Adds interest-bearing banking deposits that are guaranteed or insured by the FDIC or the National Credit Union Share Insurance and certain no-load money market funds to the list of authorized investments.
  - With respect to repurchase agreements, guaranteed investment contracts, and hedging transactions, an issuer may agree to waive sovereign immunity from suit or liability for the purpose of adjudicating a claim.
  - Provides certain requirements for investment pools.
  - Establishes hedging transactions as an authorized investment for an “eligible entity.”
- **H.B. 1238 (effective September 1, 2017); S.B. 1488**
  - Providing training requirements for officers of public housing authorities.

# Municipal Investments: 2017 Legislation

- **H.B. 1701 (effective September 1, 2017)**
  - This legislation revises the types of business entities that are subject to the acknowledgement requirements of the PFIA.
- **H.B. 2647 (effective June 15, 2017)**
  - Adds certain interest-bearing banking deposits to the list of authorized investments under the PFIA.

# Municipal Investments: 2017 Legislation

- **H.B. 2928 (effective September 1, 2017)**
  - Obligations, including letters of credit of the Federal Home Loan Banks, are added as an authorized investments under the PFIA.
  - Adding the requirement that a certificate of deposit or share investment must be secured in accordance with the Public Funds Collateral Act.
- **S.B. 253 (effective May 23, 2017)**
  - Except as provided by Chapter 2270, Texas Gov't Code, an entity is not required to liquidate investments that were authorized investments at the time of purchase.
  - Chapter 806, Texas Gov't Code is redesignated as Chapter 2270, Texas Gov't Code, and renamed "Prohibitions on Investing Public Money in Certain Investments."



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**Questions?**