

ATTORNEY GENERAL OF TEXAS
G R E G A B B O T T

A City's Authority to Make Grants and Loans

Chapter 380 of the Local Government Code provides significant legislative authority for Texas municipalities in the area of economic development. When a city wants to provide a grant or a loan of city funds or services in order to promote economic development, it generally cites its powers under Chapter 380. Cities have utilized provisions under this law to provide myriad incentives that have drawn businesses and industries to locales throughout Texas. Unfortunately, there is very little written to date that clarifies the legal parameters for providing such loans or grants. This section will attempt to provide some guidance in this area. The text of Chapter 380 is very short, but its importance to economic development cannot be overstated. Provided below, in pertinent part, is the wording of Chapter 380 of the Local Government Code.

Section 380.001 Economic Development Programs

(a) The governing body of a municipality may establish and provide for the administration of one or more programs, including programs for making loans and grants of public money and providing personnel and services of the municipality, to promote state and local economic development and to stimulate business and commercial activity in the municipality.

(b) The governing body may:

- (1) administer a program by the use of municipal personnel;
- (2) contract with the federal government, the state, a political subdivision of the state, a nonprofit organization, or any other entity for the administration of the program; and
- (3) accept contributions, gifts, or other resources to develop and administer a program.

What this statute allows is the provision of loans and grants of city funds, as well as the use of city staff, city facilities or city services, at minimal or no charge. Whether a city provides any such incentive is completely discretionary. The provision of grants and loans should be used with caution and with attention to necessary safeguards.

To establish a loan or grant, or to offer discounted or free city services, the city must meet the requirements contained in the Texas Constitution and in applicable Texas statutes. Additionally, cities must review their city charters and any other local provisions that may limit the city's ability to provide such a grant or loan. A discussion of these issues follows.

Effective September 1, 2001, a home rule city may grant public money from authorized sources to a Section 4A or Section 4B economic development corporation under a contract authorized by Section 380.002 of the Local Government Code.⁸²⁵ The Section 4A or Section 4B economic development corporation is required to use the money for "the development and diversification of the economy of the state, elimination of unemployment or underemployment in the state, and development and expansion of commerce in the state."⁸²⁶

Ensuring that a Public Purpose Is Served by the Incentive

First, any expenditure in the form of a grant, loan or provision of city services at less than fair market value involves a donation of public property. Article 3, Section 52-a of the Texas Constitution sets up the constitutional framework for public funding of economic

development efforts. It provides that economic development is a public purpose. However, a city may not simply write out checks to interested businesses in order to promote economic development. The city must ensure that the public purpose of economic development will be pursued by the business. For example, if a city provides a grant or a loan to an industry, the city should enter into a binding contract with the funded industry that outlines what steps the business will take that justify the provision of public funding (creation of jobs, expansion of the tax base by construction or enhancement of the physical facilities, etc.). The city should include a recapture provision in the agreement, so that if the business does not fulfill its promises, the city will have a right to seek reimbursement of the incentives that were provided. Any such agreement should also include tangible means for measuring whether the industry has met its obligations under the contract. Without these safeguards and a demonstrable benefit to the municipality, such incentives may not pass constitutional muster for serving a public purpose.⁸²⁷

Requirements Under the Local Government Code

Any grant or loan must also meet certain statutory requirements. Chapter 380 of the Local Government Code requires that in order for a city to provide a grant or a loan, it must “establish a program” to implement the incentive. The program may be administered by city personnel, by contract with the federal government, the state, or a political subdivision or by contract with any other entity. The applicable statutes do not indicate specifically how such a program is to be administered. It is safe to expect that the program should be planned and outlined in a written document that includes, at a minimum, the safeguards discussed above.

Additionally, any such grant or loan must meet the requirements under the budget law contained in Chapter 102 of the Local Government Code. Specifically, any economic development-related expenditure of city funds must be made pursuant to consideration and approval of the item at an open meeting of the city council. If the expenditure was not included within the original budget, the city council would need to pursue a budget amendment.⁸²⁸

Compliance with Applicable City Charter Provisions and Local Policies

Home rule cities (cities with a population of over 5,000 that have adopted a city charter) generally may take any actions that are authorized by their city charter and that are not inconsistent with the Texas Constitution, Texas statutes or federal law.⁸²⁹ Home rule cities must always review the city charter to determine whether it contains any limitations on the ability of the city to make various expenditures. Sometimes a city charter will be more restrictive than state law or will require a supermajority vote for the approval of certain types of expenditures.

Cities with a population of under 5,000 are usually general law cities. General law cities do not have a city charter and are limited by state law in terms of what expenditures may be made and how to approve them. Accordingly, general law cities must be able to cite a statute that authorizes the type of expenditure or action they are contemplating as part of their economic development program.

Often, Chapter 380 of the Local Government Code will provide that authority. If a general law city cannot find any statutory authority for the action it wants to take, it does not have authority to take the action. Of course, the city council of a general law city may impose additional local restrictions on the ability of the city to expend money for certain

purposes. The city would have to comply with any such self-imposed limitations or rights.

Review for Conflict With City Bond and Grant Documents

If a city endeavors to offer its city services on a reduced or no-cost basis, the city must review any bond documents that may have been executed with regard to those services. The bond documents must be analyzed to ensure that providing reduced or no-cost service is permitted. For example, if a city has issued bonds to fund a municipal utility system or to fund some other type of public facility, the bond documents may prohibit the city from giving away its utility services or otherwise limiting any other revenue stream until the bonds are fully repaid.⁸³⁰ Before the city agrees to any type of incentive that involves a gift of public services or funds, it should have its bond counsel and local city attorney review any existing bond and other debt instruments in this regard. This type of limitation may also be part of the conditions placed on a city if it is a recipient of a state or federal grant. Accordingly, the city should review any grant documents it has in its possession to determine if there is any such limitation.

With regard to utility service in particular, Texas Government Code Chapter 1502 generally prohibits city-owned utilities from providing free utility services, except to city public schools or to buildings and institutions operated by the city. That statute also requires that the rates charged for utility service be equal and uniform.⁸³¹

Executing Debt Versus Using Current Funds

It is clear from Chapter 380 of the Local Government Code that a city may provide “loans and grants of public money” from the city’s current funds. However, Chapter 380 does not provide any express authorization for the city to finance such a program through the issuance of debt or bonds. Texas courts have long required a city to cite specific legal authority for the issuance of any debt instrument. Debt is defined as any obligation that is not completely paid within the current fiscal year from budgeted revenue.⁸³²

If the city is a home rule city, it can look to the provisions of its city charter for authority to issue debt, as long as those provisions are not inconsistent with state law. A home rule city has the power to issue bonds to the extent provided in the city charter, assuming that the bonds have first been authorized by voters at an election held on the issue.⁸³³ Often, however, a city charter is silent as to the authority of the city to issue bonds or other debt instruments to promote economic development.

If this is the case, the city will need to find other authority within Texas state statutes that allows for the issuance of bonds or debt to finance economic development.

If the city is a general law city, it may not issue debt except when there is specific statutory authority that permits the issuance of debt for that purpose. A general law city is limited to taking only those actions that are specifically authorized under the general statutes of Texas. Accordingly, a general law city could fund economic development programs with current city funds under Local Government Code Chapter 380. However, such cities cannot issue debt or bonds without finding specific legislative authority for that type of transaction. For further discussion on the ability of general law cities and home rule cities to issue debt, see the section in this handbook on Issuing Debt To Finance Economic Development.

Use of Dedicated Tax Funds for Economic Development

Effective September 1, 2001, a home rule city may grant public money to a Section 4A or Section 4B economic development corporation under a contract authorized by Section

380.002 of the Local Government Code.⁸³⁴ However, the funds granted by the city to the Section 4A or Section 4B corporation must be “derived from any source lawfully available to the municipality under its charter or other law, other than from the proceeds of bonds or other obligations of the municipality payable from ad valorem taxes.”⁸³⁵ If a city is using funds other than the property tax, care must be taken to ensure that the city is complying with any limitations imposed on the use of such funds by statute (e.g., statutory provisions relating to dedicated funds, such as the economic development sales tax, hotel occupancy tax, etc., that limit the purposes for which those funds may be used). For this reason, there is a section in this handbook on the local hotel occupancy tax and the purposes for which its revenues may be used. There is also a chapter on the sales tax for economic development and the purposes for which that dedicated tax may be used. A city should consult these portions of the publication and the applicable law to be certain the revenues are used as permitted by law.

AG OPINIONS:

Loans Under Local Government Code Chapter 380

GA-0137 Municipal Sales Tax Agreements

House Bill 3534, which amended sections 321.002(a)(3) and 321.203 of the Tax Code, prevents certain outlets, offices, facilities or locations from qualifying as a “place of business of the retailer” for municipal sales tax purposes. House Bill 3534 does not invalidate existing municipal sales tax rebate contracts nor prohibit municipalities and businesses from executing new contracts.

GA-0071 Municipal Sales Tax Rebates

If a business collects and remits municipal sales taxes as required by law, the city’s rebate of those taxes to the business does not violate article III, section 55 of the Texas Constitution. *See* TEX. CONST. art. III, § 55 (prohibiting the legislature and political subdivisions from “releasing or extinguishing, in whole or in part, the indebtedness, liability or obligation of any corporation or individual” to the state or political subdivision).

LO 95-090 City Cannot Abate Delinquent Taxes

Neither Local Government Code section 380.001 nor Tax Code section 312.204 authorizes a municipality to abate delinquent taxes owed by a taxpayer who participates in the municipality’s enterprise zone. Moreover, article III, section 55 of the Texas Constitution expressly forbids the abatement of delinquent taxes.

DM-0185 Economic Development Program

Section 380.001 of the Local Government Code, which the legislature enacted pursuant to article III, section 52-a of the Texas Constitution, is constitutional. The legislature intended section 380.001 to authorize municipalities to offer a range of incentives designed to promote state or local economic development. It is outside the scope of the opinion process to determine, however, whether a particular incentive or combination of incentives constitutes a “program . . . to promote state or local economic development” for purposes of section 380.001 of the Local Government Code.

A home-rule municipality may issue bonds to fund an economic development program that the municipality has established in accordance with section 380.001, but only if two conditions are met.

First, the bonds must be in an amount and to the extent allowed by the city charter. Second, a majority of the duly qualified property tax-paying voters must approve the bond issuance at an election held to consider the issue.

NOTE: from Joe N.:

In 2005, the legislature added HB 918 by Krusee/Wentworth that expands a municipality's authority to create economic development programs including making loans and grants of public money under Chapter 380 of the Local Government Code to areas annexed for limited purposes and to a city's extra-territorial jurisdiction.