



BULLETIN

No. B-87-5

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This BULLETIN is to remind you of the applicable Tennessee law in regard to the making of loans to local governmental entities in Tennessee. The information provided here reiterates former Commissioner W. C. Adams' June 7, 1985, letter on the same subject that was sent to all state banks.

Each year, the Department of Audit of the Tennessee Comptroller of the Treasury audits or reviews the audits of all county and municipal governmental accounts. The Department of Audit has determined that these governmental entities have occasionally borrowed funds from certain financial institutions without first having the transaction approved by the State Director of Local Finance.

State law requires that the Director of Local Finance approve the borrowing authority of a municipality before it incurs indebtedness on capital outlay expenditures [T.C.A. §7-36-103(18)(A), grant anticipation notes [T.C.A. §7-36-103(18)(D), bond anticipation notes [T.C.A. §7-36-103(18)(E)(i), or tax anticipation notes [T.C.A. §7-36-103(18)(E)(iv); and before a county incurs indebtedness on capital outlay notes [T.C.A. §5-10-501(a)], grant anticipation notes [T.C.A. §5-10-502], and tax anticipation notes [T.C.A. §5-10-505].

Failure to comply with the requirements provided in the above statutes, including the lack of approval from the State Director of Local Finance, renders the note illegal and void. [See T.C.A. §7-36-103(18)(E)(vii), Supp. 1984] as to municipalities; and [T.C.A. §5-10-508 as to counties.] In such cases, any payments received by the lender on those notes will be deemed a misappropriation of public funds and may be recovered from the lender for the use and benefit of the appropriate local government body.

State banks are directed to include the advice contained in this BULLETIN into your Loan and/or Investment Policies. It is further the policy of this department that state banks must secure a legal opinion (from the city or county attorney or independent counsel) that the requirements of State law relative to loans to local governments have been met before the loan may be closed.

The bank's loan file should contain, at least, the requisite legal opinion and an approval letter from the State Director of Local Finance approving the borrowing. Borrowers not so documented will be subject to adverse classification by State examiners.

Questions about these matters should be addressed to Mr. H. Wayne Williams, Director of Local Finance at (615)741-4272.