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# JustLaws

## MEMORANDUM

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Date: January 20, 2017  
Subject: Philadelphia's Authority to Create a Municipal Bank  
From: Steve Masters, Esquire  
To: Stan Shapiro, Pennsylvania Project, Inc.

### QUESTIONS PRESENTED

In response to interest in Philadelphia in establishing a municipal bank, this memo addresses two questions:

1. Does Philadelphia have the power to act under its home rule authority or other statutory authority to establish a municipal bank?
2. Do any provisions in the Pennsylvania Constitution or Pennsylvania statutes prohibit the City of Philadelphia from establishing a municipal bank?

### BACKGROUND

Municipal banks, an initiative proposed by local advocates, would allow cities to create and operate locally controlled and democratically accountable systems of public finance. More specifically, by leveraging the City's financial resources, municipal banks promote community development and the local economy and increase opportunities for underserved economically disadvantaged segments of the city to access banking services. The duties of a municipal bank could include banking functions, issuing debt, acquiring and refinancing the city's general obligation debt, and offering participation loans for small businesses in partnership with local credit unions, local banks, and CDFIs.

State ownership of banks was common in the early years of the United States, especially in Pennsylvania.<sup>1</sup>

Pennsylvania's first state bank, the Bank of Pennsylvania, was created by legislative charter in 1793. From its inception, the Commonwealth was heavily invested in the bank, providing \$1 million of the bank's original capitalization. In return, the charter mandated that six out of the thirteen directors would be appointed by the government and that the bank would guarantee the Commonwealth a \$500,000 line of credit at a constant 6 percent interest. "The bank became the state's fiscal agent, which meant a constant inflow of deposits as the monies from western land sales flowed into the state treasury and thus into the bank." Bodenhorn, Howard, *A History of Banking in Antebellum America: Financial Markets and Economic Development in an Era of Nation-Building*, Cambridge University Press, February 13, 2000, p. 36.

The Philadelphia Bank was chartered by the legislature in 1803 at request of Philadelphia merchants who felt marginalized by the lending policies of the Bank of North America and the Bank of Pennsylvania. The Commonwealth provided one sixth of the Philadelphia Bank's original capitalization - \$300,000 – and reserved the option to acquire a greater ownership share at a later date. And like the Bank of Pennsylvania, the Philadelphia Bank agreed to open a substantial line of credit for the Commonwealth. *Id.*

In 1803, the Commonwealth owned thirteen twenty-thirds of Bank of Pennsylvania stock but had power to appoint only six twenty-fifths of the directors. When the Philadelphia Bank was finally incorporated, the Commonwealth owned three-thirteenths

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<sup>1</sup> Indiana and Tennessee also created state-owned banks during the early to mid-1800s.

of its stock and was represented by three-elevenths of the directors. Schwartz, Anna Jacobson, *The Beginning of Competitive Banking in Philadelphia, 1782-1809*, Journal of Political Economy, Vol. 55, No. 5 (Oct., 1947), pp. 417-431 (citing House Journal 1803-4, pp. 257-58; Senate Journal 1803-4, p. 273). By 1813, the Commonwealth's ownership shares in each of its chartered banks had grown - \$1,500,000 in the Bank of Pennsylvania, \$523,000 in the Philadelphia Bank, and \$85,400 in the Farmers and Mechanics Bank, with the dividends constitution a significant share of the Commonwealth's revenues." Bodenhorn at 36.

Today, both the Commonwealth and the City of Philadelphia engage in direct banking activities through various city agencies. The Commonwealth even uses the name "bank" to describe its state revolving fund (SRF) - the Pennsylvania Infrastructure Bank (PIB).

PIB is a revolving loan fund administered by PennDOT that offers flexible financing opportunities for eligible transportation improvement projects throughout the Commonwealth. PIB provides direct, low-interest loans that are repaid over time. Repayments are recycled into new project loans, creating new financing opportunities. PIB was capitalized with Federal and state funds in 1998, in accordance with 1997 enabling legislation and a Cooperative Agreement between PennDOT and the U.S. Department of Transportation (DOT). PIB encompasses four separate accounts: highway/bridge, transit, aviation, and rail freight. Loans to eligible projects are made from one of these four accounts.

While not accepting deposits, PIB acts like a conventional bank in all other respects. PIB's Handbook describes the terms of the irrevocable standby Letter of Credit

the PIB applicant's bank issues to repay the PIB loan if the applicant defaults - PIB is named as the beneficiary on the letter of credit and the applicant, the bank, and PennDOT must agree to any changes, and the bank must examine the quality and liquidity of the collateral offered by the applicant before the letter of credit is issued. See Pennsylvania Infrastructure Bank Handbook at 10.

In its September 2012 report "Banking on Infrastructure: Enhancing State Revolving Funds for Transportation", the Brookings-Rockefeller Project on State and Metropolitan Innovation explains that "[state revolving] funds act like a bank, in that they do not own the infrastructure asset, but act as a lender or guarantor to the project sponsor. . . . Combining the private functions of a bank with a public agency allows sectors and borrowers that have historically not been major recipients of private investment the opportunity to receive financing." *Id.* at 2.

The City of Philadelphia has in recent years operated a number of municipal revolving loan funds. Among them are the \$1 million PAID brownfields remediation revolving loan fund, the \$2.35 million PAID Economic Development Revolving Loan Fund to respond to the closing of three Navy facilities in Philadelphia and the Greenworks Revolving Loan Fund, where the Office of the Deputy Mayor for Planning and Economic Development serves as the lead agency and PIDC and Reinvestment Fund providing technical expertise with origination of the loans.<sup>2</sup>

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<sup>2</sup> The Greenworks Loan Fund is designed to mirror the process of other real estate loans, except that it offers a below-market interest rate (3%-7%), and it finances only those aspects of a project that improve energy efficiency: mechanical systems, lighting, on-site renewable energy, combined heat and power, appropriate construction materials and building operation practices, to name a few.

## LEGAL ANALYSIS

### 1. Philadelphia is Authorized to Establish a Municipal Bank Under the City's Home Rule Powers

Municipalities are creatures of the state and have no inherent powers of their own, see *Naylor v. Township of Hellam*, 565 Pa. 397, 403, 773 A.2d 770, 773 (2001); rather, they “possess only such powers of government as are expressly granted to [them] and as are necessary to carry the same into effect.” *Appeal of Gagliardi*, 401 Pa. 141, 143, 163 A.2d 418, 419 (1960); see also *Philadelphia v. Fox*, 64 Pa. (14 Smith) 169, 180-81 (1870). Therefore, a municipality ordinarily lacks the power to enact ordinances except as authorized by statute, and any ordinance not in conformity with its enabling statute is void. See *Taylor v. Abernathy*, 422 Pa. 629, 633, 222 A.2d 863, 865 (1966).

Under the concept of home rule, however, Philadelphia may legislate concerning municipal governance without express statutory warrant for each new ordinance; rather, its ability to exercise municipal functions is limited only by its home rule charter, the Pennsylvania Constitution, and the General Assembly. See *In re Petition to Recall Reese*, 542 Pa. 114, 119, 665 A.2d 1162, 1164 (1995). See generally PA. JUR.2D Municipal and Local Law § 3:42 (2002); McQuillin, *THE LAW OF MUNICIPAL CORPORATIONS* § 10:13 (3d ed.2004); Gary E. French, *Home Rule in Pennsylvania*, 81 *DICK.L.REV.* 265 (1977).

Therefore, in analyzing whether Philadelphia has the ability to act on a specific issue, we must ask: first, whether Philadelphia possesses the power to act, and second, whether there exists a limitation on that power.

Although the right to home rule is guaranteed by the Pennsylvania Constitution, see PA. CONST. art. IX, § 2, that right is effected through enabling legislation such as the First Class Cities Home Rule Act, which identifies those powers that fall within the category of home rule powers and those that do not. Section 17 of the Home Rule Act grants Philadelphia complete powers of legislation and administration in relation to its municipal functions. 53 P.S. § 13131. This grant of powers is made subject to limitations, restrictions and regulations enumerated in Section 18 of the Home Rule Act, 53 P.S. § 13133. See *City of Philadelphia v. Schweiker*, 858 A.2d 75, 84 (Pa. 2004). Section 18 of the Home Rule Act states unambiguously “. . . no city shall engage in any proprietary or private business except as authorized by the General Assembly.”

Therefore, the threshold question is whether the operation of a municipal bank is a permitted municipal function or a prohibited proprietary or private business.

The early history of government-owned banks in Pennsylvania provides clear evidence that the creation and maintenance of banking institutions has historically been a core government function and in the intervening two hundred twenty five years the City has continued to manage its financial affairs as a core government function.

Section 6-300 of the Philadelphia Home Rule Charter places the responsibility for safeguarding and managing Philadelphia’s funds with the City Treasurer: “The City Treasurer shall receive from the Department of Collections daily all moneys received by that Department from any source and shall make daily deposits of such moneys in such banks or institutions as may be designated by the Council.” This charter provision derives its authority from the First Class City Government Law, Act of June 25, 1919, codified at 53 P.S. §12395, which states:

The city treasurer shall keep the accounts arising from the several sources of revenue and income separate and distinct from one another, and shall make daily deposits of all moneys received by him in such banks or institutions as may be designated by the council, and shall make specific reports daily to the city controller of all receipts and deposits and of all moneys withdrawn from the treasury, and shall present and verify his cash account in such manner and as often as may be required.

Both the statute and charter authorize Council to “designate” appropriate institutions in which the City Treasurer may invest City funds, thereby limiting the City Treasurer’s discretion by limiting the number of institutions in which the City Treasurer may invest City funds. Numerous Solicitor’s Opinions have upheld Council’s unfettered power to designate appropriate institutions to hold City Funds. See e.g. Opinion 05-16 (“placing obligations on financial institutions as conditions for serving as City depositories . . . are lawful expressions of Council’s powers”); Opinion No. 06-19 (“Council’s power to establish a list of approved depositories includes the power to designate, in that list, which depositories can be used for certain purposes, and which depositories can be used for other purposes”); Opinion No. 00-05 (“Council is free to make a legislative judgment that investment in CDFIs is an appropriate medium for preserving, maintaining and managing City money, subject of course to the professional judgment of the City Treasurer”).

The municipal management of City Funds is regulated in Chapter 19-200 of the Philadelphia Code. Section 19-201 contains the list of approved depository institutions from which the City Treasurer may choose to hold City Funds. Section 19-202 expands the Treasurer’s options by providing a list of institutions in which the Treasurer may

invest the City Funds in short term obligations which mature at most one year from the date of investment.

While the City's financial investments are typically managed by private bank(s) using demand deposits of the City's funds, we have described above how several city agencies and authorities also operate revolving loan funds, providing city initiated loans to private businesses and individuals throughout the City.

Although these revolving loan funds invest city funds directly in private entities and individuals, their activities do not constitute unauthorized "proprietary or private business" activities in violation of Section 18 of the Home Rule Act. The proprietary business prohibition under Section 18 refers to private enterprises carried out for private purposes. So long as the city's financial lending activities are designed to achieve a public purpose, which is the case for each of the revolving loan funds, the authority to operate these loan funds flows from the city's home rule powers, even though the loan funds have distinct proprietary characteristics.

"[A] municipal corporation carries out both "governmental" and "proprietary" functions." *City of Philadelphia v. Schweiker*, 579 Pa. 591, 858 A.2d 75, 87 (Pa. 2004). Examples of proprietary functions that a municipality carries out are maintaining parks and playgrounds, *DeSimone v. City of Philadelphia*, 380 Pa. 137, 110 A.2d 431 (1955), and the distribution of water, *Helz v. City of Pittsburgh*, 387 Pa. 169, 127 A.2d 89 (1956). All of these municipal activities are protected under Article 9, § 2 of the Pennsylvania Constitution, which shields a municipality from the General Assembly directing or interfering how that municipality can carry out its municipal functions. *City of*



*Philadelphia v Rendell*, 888 A.2d 922, 940, (Pa. Cmwlth. 2005) (concurring and dissenting opinion of Judge Pelligrini).

A municipal bank, organized for a public purpose, would provide similar financial services and be capitalized with the same funds as the city's current revolving loan funds. It is therefore likely that a court would find that the creation and operation of a municipal bank to be a "municipal function" protected by Article 9, §2 of the Pennsylvania Constitution.

In fact, the only possible distinction between a municipal bank and existing state and municipal revolving loan funds could be that a municipal bank temporarily utilizes city funds which are appropriated for other public purposes, whereas the revolving loan funds are typically capitalized through direct appropriations and grants.

And yet, that distinction would only be material if a municipal bank could be found to meet the statutory definition of a depository institution and thereby be subjected to the extensive system of federal and state regulations which govern depository institutions. The Banking Code of 1965 is the controlling statute regulating banks in the Commonwealth. The Banking Code defines a depository institution as a business engaged in receiving money for deposit or transmission. 7 P.S. § 105. A municipal bank holding only the City's funds would not receive any money for deposit or transmission belonging to any other entity or person. It would therefore not be subject to regulation on the state or federal level as a depository institution, rendering it legally identical to state and municipal revolving loan funds in current operation.

While it appears that the City could exercise its home rule powers to enact legislation to direct the City Treasurer to retain the City's Funds and invest them without

the need to place them into the hands of a private bank, it may be preferable for a variety of reasons to establish a separate entity which would be distinct from the city and could receive a state bank charter. The next section explores this option.

## **2. A Municipal Financing Authority Created by the City of Philadelphia Could Possess the Legal Authority to Incorporate as a Bank and Apply for a State Bank Charter**

Philadelphia has long utilized its powers under various state statutes governing the creation of municipal authorities to conduct proprietary and private business activities such as the many revolving loan funds described above.<sup>3</sup>

Our courts have found that authorities are “public corporations, being corporate agencies engaged in the administration of civil government.” *Lighton v. Abington Township*, 336 Pa. 345, 353, 9 A.2d 609, 613 (1939). Unlike municipal corporations that have both “governmental” and “proprietary” functions, authorities engage only in the latter and are generally established to finance and managing various revenue producing projects with a public purpose or other activities that are not considered to be part of core governmental activities; “they are a governmental business venture, a form of quasi-privatization.” *Schweiker*, 858 A.2d at 87.

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<sup>3</sup> Although the Home Rule Charter prohibits City Council from creating a new authority without state authorization, the charter provides that, “any additional executive and administrative power . . . conferred . . . by the laws of the Commonwealth of Pennsylvania shall be vested in and exercised by the Mayor . . .” PHRC 1-102(2). Also, the Mayor appoints members of all boards and commissions. PHRC 3-207. Finally, all members serve at the pleasure of the Mayor. PHRC 3-404.

Based upon its sweeping grant of powers and the lack of any required public purpose for any project receiving financing, the Economic Development Financing Law, 73 P.S. §371 appears to present the most promising basis for the creation of a municipal financing authority.<sup>4</sup>

The most closely analogous existing municipal authority is the Philadelphia Authority for Industrial Development which was incorporated on December 27, 1967, pursuant to an Ordinance of City Council enacted on October 25, 1967 (1967 Ordinances 1414), pursuant to the Economic Development Financing Law (Act of 1967) of August 23, 1967, P.L. 251, §1; 73 P.S. § 371. That statute enumerates the method of incorporation, the powers and duties as well as the governing body for the authority. It contains broad and sweeping powers for the authority to engage in all manner of financing, which a court is likely to find includes banking:

Section 372.1(14)

Otherwise promote the health, welfare and safety of the residents of this Commonwealth by promoting economic activity and efficiency, by alleviating or eliminating unemployment, blight and other unhealthy conditions and by otherwise providing public benefit and prosperity and to do or perform any of the above **regardless of whether the project, the project applicant or the project user is public or private or done with a profit or not-for-profit purpose.**

The next section contains the most expansive definition of financing to be found in any of the statutes authorizing authorities:

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<sup>4</sup> While the name Municipal Bank Authority would seem more suitable for the authority's name, it could be misconstrued as constituting a bank holding company unintentionally subjecting the authority to intensive regulation by the Federal Reserve.

§ 372.2. Construction

This act shall be liberally construed in order to effect the legislative and public purposes of sections 2 and 2.1 of this act. The terms “finance” and “financing,” as used in this act, shall be given the broadest possible interpretation and shall include, but not be limited to, refinance and refinancing.

Compare these broadly defined powers with the more limited powers under the

Municipality Authorities Act, 53 Pa.C.S. §5607(a)(14):

Every authority incorporated under this chapter shall be a body corporate and politic and **shall be for the purposes of financing working capital**; acquiring, holding, constructing, **financing**, improving, maintaining and operating, owning or leasing, either in the capacity of lessor or lessee, projects of the following kind and character and providing financing for insurance reserves:

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Industrial development projects, including, but not limited to, projects to retain or develop existing industries and the development of new industries, the development and administration of business improvements and administrative services related thereto.

Section §1002 of the Banking Code provides that any bank, bank and trust company, a trust company or a non-mutual savings bank may be incorporated upon the application of at least three adults, “who shall each subscribe to shares of common stock with an aggregate par value of at least one thousand dollars (\$1,000)” provided that at least two-thirds of the incorporators are citizens of the United States and at least two-thirds are residents of Pennsylvania. 7 P.S. §1002.<sup>5</sup>

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<sup>5</sup> The Banking Code limits incorporators of a depository institution to adult persons and does not appear to permit an institution or government body to found a banking institution. It is not clear if the Department of Banking would recognize three board members of a municipal authority as acceptable incorporators or if an amendment to the Banking Code would be required to permit the authority to incorporate as a chartered bank.

A municipal financing authority would be empowered to create a state chartered depository institution pursuant to Section 376(b)(4) of the Economic Development Financing Law, which authorizes that authority to “acquire, purchase, own, hold, lease as lessee and use any franchise, property, real, personal or mixed, tangible or intangible, or any interest therein necessary or convenient for carrying out the purposes of the authority.” 73 P.S. §376(b)(4).

While the choice of bank entity, its structure and its scope of operations are beyond the scope of this memo and should be determined in consultation with an attorney who specializes in banking law, Article 6-300 of the Home Rule Charter mandates that the City deposit all moneys received by the Department of Revenue into banking institutions which conform to the requirements of Chapter 19-200 of the Philadelphia Code. A state chartered municipal bank, regulated by both the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation would certainly meet the Home Rule Charter’s tests for an acceptable depository institution.

### **3. There are no Constitutional or Statutory Impediments to the Creation of a Municipal Bank by a Municipal Financing Authority**

Article IX, Section 9 of the Pennsylvania Constitution prohibits any municipality from becoming a stockholder in any company, association or corporation, or to obtain or appropriate money for, or to loan its credit to, any corporation, association, institution or individual and requires all appropriations to be undertaken for a public purpose.

Both options discussed above, establishing a municipal bank within the city itself or creating a municipal bank authority under the Economic Development Financing Law, would ensure that the City would not run afoul of this constitutional provision. See

*Basehore v. Hampden Indus. Development Authority*, 433 Pa. 40, 248 A.2d 212 (1968) (upholding the constitutionality of the Economic Development Financing Law against claims it violated the precursor amendments now codified in Article IX, Section 9).

A municipal bank created inside the City would not require any debt financing so its capitalization would not impair the credit of the City. In the case of a municipal bank authority, the Economic Development Financing Law specifically states that any money borrowed by an authority shall not be the debt of either the Commonwealth or any political subdivision:

An authority created hereunder shall have no power at any time or in any manner to pledge the general credit or taxing power of the Commonwealth of Pennsylvania or any political subdivision, and the obligations of the authority shall be limited as provided in section 7(a) hereof. The bonds of the authority shall on the face thereof clearly set forth the foregoing limitation.

73 P.S. § 376.3(c)

Finally, the question of whether the creation and financing of a municipal bank constitutes a valid public purpose under Article IX Section 9 was resolved long ago by the Commonwealth of Pennsylvania purchasing substantial ownership interests in three state chartered banks at the dawn of our nation. After the State of North Dakota established a state-owned and operated bank in 1920, both the North Dakota Supreme Court and the U.S. Supreme Court upheld its validity in the face of federal and state constitutional challenges. *Green v. Frazier*, 253 U.S. 233; 40 S. Ct. 499; 64 L. Ed. 878 (1920) (upholding constitutionality of state-owned and operated bank under 14<sup>th</sup> Amendment challenge); *Green v. Frazier*, 44 N.D. 395, \*413; 176 N.W. 11, \*\*18; (N.D. 1920) (upholding constitutionality of state-owned bank under state constitution); accord *Baseshore* 433 Pa.

at 52, 248 A.2d at 219 (holding that agreements entered into by authorities created under the Economic Development Financing Act are always for a public purpose).

### **CONCLUSION**

It is likely that a court would find that the Pennsylvania Constitution and state statutes permit the City of Philadelphia to create a municipal bank inside city government under its home rule powers or through establishing a municipal bank authority under the Economic Development Financing Law.