



San Jacinto River Authority

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OPINION COMMITTEE

Via E-Mail: Opinion.Committee@texasattorneygeneral.gov

Honorable Ken Paxton
Attorney General of Texas
Attention: Opinion Committee
P.O. Box 12548
Austin, Texas 78711-2548

FILE # ML-48035-16
I.D. # 48035
RQ-0114-KP

Re: Request for opinion on matters concerning public funds of local government bodies subject to the requirements of the Public Funds Investment Act, chapter 2256, Texas Government Code, and the Public Funds Collateral Act, chapter 2257, Texas Government Code

Dear General Paxton:

The San Jacinto River Authority (the "SJRA") is a conservation and reclamation district, a governmental agency, and a political subdivision of the State of Texas created by special act of the Texas Legislature codified at Article 8280-121 V.T.C.S., as amended, under authority of Article XVI, Section 59, of the Texas Constitution. Its mission is to develop, conserve, and protect the water resources of the San Jacinto River basin.

The SJRA is one of ten major river authorities in the State of Texas, and it serves to implement long-term, regional projects related to water supply and wastewater treatment. To meet the financial demands associated with these projects, the SJRA must maintain significant deposits and investments of public funds in accordance with Texas law, including both the Public Funds Investment Act, chapter 2256, Texas Government Code (the "PFIA"), and the Public Funds Collateral Act, chapter 2257, Texas Government Code (the "PFCA"). As President of the Board of Directors of the SJRA, I respectfully request your opinion on several questions regarding the requirements of the PFIA and PFCA. Specifically, my questions concern the eligibility of certain time deposits and demand deposits under the PFIA and PFCA.

PFIA Background Information

The PFIA applies to several types of governmental entities in Texas, including local governments. TEX. GOV'T CODE ANN. §2256.003(a)(1) (West 2015). Under the PFIA, the term "local government" includes districts and authorities created under Article XVI, Section 59 of the Texas Constitution, such as the SJRA. The PFIA permits the SJRA to purchase, sell, and invest its funds, and any other funds it controls, in certain investments authorized under Subchapter A of the PFIA. *Id.* §2256.003(a). Such investments must be in compliance with the investment

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policy approved by the Board of Directors of the SJRA and made in accordance with the standard of care prescribed by Section 2256.006 of the PFIA.¹ *Id.* §2256.003(a).

The PFIA uses several provisions to describe which investments are considered "authorized investments." Section 2256.009(a) lists various authorized investments which are obligations of or are guaranteed by governmental entities. These include: (i) obligations, such as letters of credit, of the United States or its agencies and instrumentalities; (ii) direct obligations of the State of Texas or its agencies and instrumentalities; (iii) State of Israel bonds; (iv) obligations of political subdivisions of any state meeting a certain investment rating; and (v) collateralized mortgage obligations direct issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States. *Id.* §2256.009(a).

Additionally, section 2256.009(a)(4) lists "other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities" as an authorized investment. *Id.* §2256.009(a)(4). This includes obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation (the "FDIC") or by the explicit full faith and credit of the United States. *Id.*

Other provisions of the PFIA describe different types of authorized investments, including repurchase agreements, commercial paper, and mutual funds. *E.g., id.* §§2256.009, 2256.010, 2256.011, 2256.013, 2256.014. Of particular importance to this request, Section 2256.010(a) states that a certificate of deposit or share certificate is an authorized investment under this subchapter if the certificate is issued by a depository institution that has its main office or a branch office in Texas and is: (i) guaranteed or insured by the FDIC or its successor or the National Credit Union Share Insurance Fund or its successor; (ii) secured by obligations listed above as included in section 2256.009(a); or (iii) secured in any other manner and amount provided by law for deposits of the investing entity. *Id.* §2256.010(a).

In a previous opinion, Opinion No. GA-0834, the Attorney General's Office explained that the PFIA permits a local government to place its funds in money market deposit accounts fully backed by the FDIC. *Tex. Att'y Gen. Op. No. GA-0834 (2011)*. In this opinion, the Attorney General's Office explained that nothing in statutory or case law could be found to indicate that a demand account cannot properly be deemed an "other obligation" under Section 2256.009. *Id.* at 1. The opinion emphasizes the idea that the authority granted under the PFIA is in addition to that granted by other law and the consequences of a particular statutory construction must be considered when construing the PFIA. *Id.* at 2, citing *TEX. GOV'T CODE ANN. §2256.024(a) (West 2008)*.

¹ For each question in this request, it should be assumed that the subject investment is made in accordance with these and all other general requirements of the PFIA, including those regarding investment training, investment officers, and investment policies. *E.g., TEX. GOV'T CODE ANN. §2256.005, 2256.007, 2256.008 (West 2015)*.

The Attorney General's Office stated that the PFIA requires the principal and interest of these "other obligations" authorized as an investment by section 2256.009(a)(4) must be unconditionally guaranteed, insured by, or backed by the full faith and credit of the State of Texas or the United States or their respective agencies and instrumentalities. *Id.* at 2, citing TEX. GOV'T CODE ANN. §2256.009(a)(4) (West 2008). This includes demand deposits insured by the Federal Deposit Insurance Corporation. *Id.* at 2. However, such demand deposits are insured only to the maximum extent of federal law, which is presently \$250,000.² *Id.* at 2, citing Act of July 21, 2010, Pub. L. No. 111-203, Section 335(a)(1), 124 Stat. 1376, 1540 (2010).

The Attorney General's Office closes Opinion No. GA-0834 by reminding the requestor that the requirements of Texas law governing the money market deposit at issue were not limited to those found in the PFIA, as the deposit at issue in the request is also subject to the requirements of the PFCA. *Id.* at 2.

PFCA Background

The PFCA governs deposits of public funds by public entities, including the state and political or governmental entities, agencies, instrumentalities, or subdivisions of the state, including districts created under Article XVI, Section 59, of the Texas Constitution, like the SJRA. TEX. GOV'T CODE ANN. §§2257.002(7)-(8) and 2257.021 (West 2015). A "deposit of public funds" means public funds of a public entity that (i) are not managed by the comptroller under Chapter 404 of the Government Code and (ii) are held as a demand or time deposit by a depository institution expressly authorized by law to accept a public entity's demand or time deposit. *Id.* §2257.002(3).

Deposits of public funds must be secured by "eligible security" as specifically described in the PFCA. *Id.* §2257.021. Eligible security includes: (i) surety bonds; (ii) investment securities; (iii) ownership or beneficial interests in investment securities, other than option contracts to purchase or sell investment securities; (iv) fixed-rate collateralized mortgage obligations that have expected weighted average lives of ten years or less and do not constitute high-risk mortgage securities; (v) floating-rate collateralized mortgage obligations that do not constitute a high-risk mortgage security; and (vi) letters of credit issued by a federal home loan bank. *Id.* §2257.002(4).

Investment securities include: (i) obligations that, in the opinion of the attorney general of the United States, are general obligations of the United States and backed by its full faith and credit; (ii) general or special obligations issued by a public agency that are payable from taxes, revenues, or a combination of taxes and revenues; and (iii) securities in which a public entity may invest under the PFIA. *Id.* §2257.002(5).

² Section 2256.009(a)(4) was amended by H.B. 2206 in 2011, after the release of Opinion No. GA-0834, to add the words "including obligations that are fully guaranteed or insured by the [FDIC] or by the explicit full faith and credit of the United States."

To meet the collateral requirements of the PFCFA there must be a total value of eligible security to secure a deposit of public funds in an amount not less than the amount of the deposit of public funds plus the amount of any accrued interest, which is reduced to the extent that the United States or an instrumentality of the United States insures the deposit. *Id.* §2257.022.

A public entity may contract with a bank that has its main office or a branch office in Texas to secure a deposit of public funds. *Id.* §2257.024(a). Such contract may contain terms or conditions relating to investment securities used as security for a deposit of public funds, including terms or conditions relating to the: (i) possession of the collateral; (ii) substitution or release of an investment security; (iii) ownership of the investment securities of the bank used to secure a deposit of public funds; and (iv) the method by which an investment security used to secure a deposit of public funds is valued. *Id.* §2257.024(b).

Federal Regulation of the Banking Sector

After the financial crisis of 2007-2008, the U.S. Federal Reserve adopted recommendations from the Basel Committee on Banking Supervision in 2010 and 2011. These recommendations were dubbed "Basel I," "Basel II," and "Basel III," and were developed to correct the deficiencies in financial regulations revealed by the credit crisis of 2007 and 2008. Basel I primarily covered the minimum capital requirements for banks, while Basel II established the risk and capital management requirements of banking institutions. Basel III has evolved to cover three main areas for banking institutions:

1. Capital – Effective as of January 1, 2014, revised regulatory capital definitions and minimum capital ratios have been implemented, as well as changed risk weights for certain assets and off-balance sheet exposures.
2. Liquidity Coverage Ratio ("LCR") – Beginning in January, 2015, the LCR began its multi-year phase-in. LCR is designed to ensure that an adequate level of unencumbered, high-quality liquid assets are maintained to meet liquidity needs for a 30 day calendar time horizon. Such assets may not be pledged to secure collateralize, or enhance the credit of any transaction.
3. Net Stable Funding Ratio ("NSFR") – Beginning in 2018, the NSFR will restrict the ability of banks to fund liquid assets with short term funding maturing just outside of the LCR's 30-day time horizon, in an effort to counterbalance the effects of the LCR.

These Basel III requirements, as implemented by the U.S. Federal Reserve, are making it more difficult for banking institutions in Texas to post collateral for public entities as required by the PFCFA. As a consequence, fewer Texas banks are accepting or seeking deposits from public entities.

Time Deposits

Our first few questions deal with time deposit accounts. The PFIA and the PFCA do not give definitions of time deposits or time deposit accounts but the PFCA does specifically reference time deposits as part of its definition of "deposit of public funds."

Texas case law does not provide a working definition of "time deposit" but a few Texas statutes provide definitions that are helpful to analyses of deposits under the PFIA and PFCA. Section 105.001(5) of the Local Government Code, dealing with depositories for municipal funds, states that a "time deposit" is a "deposit of funds subject to a contract between the depositor and the depository under which the depositor may not withdraw any of the funds by check or by another manner until the expiration of a certain period following written notice of the depositor's intent to withdraw the funds." TEX. LOCAL GOV'T CODE ANN. §§105.001(5) (West 2015). Similarly, Government Code section 404.001(7), dealing with State Treasury operations, states that a "time deposit" is a "deposit for which there is in force a contract providing that neither the whole nor a part of the deposit may be withdrawn by check or otherwise before the expiration of the period of notice that must be given in writing in advance of a withdrawal." TEX. GOV'T CODE ANN. §§404.001(7) (West 2015).

While these statutory definitions are useful, a more expansive definition of "time deposit" helps to elucidate several aspects of this request and can be found in the Reserve Requirements of Depository Institutions, known as "Regulation D" and codified in Title 12, Chapter II, Subchapter A, Part 204 of the Code of Federal Regulations. *See also* Regulation D Reserve Requirements Consumer Compliance Handbook, available at https://www.federalreserve.gov/boarddocs/supmanual/cch/int_depos.pdf. Regulation D imposes reserve requirements on certain deposits and other liabilities of depository institutions for the purpose of implementing monetary policy. *Id.* at 1. It is relevant here since all depository institutions, including commercial banks, savings banks, savings and loan associations, credit unions, and agencies and branches of foreign banks located in the United States, are subject to these reserve requirements specifying how different types of deposit accounts must be classified. *Id.*

Regulation D states that a time deposit may have a maturity of seven days or more and may be payable on a specified date, after the expiration of a specified period of time, or upon receipt of written notice from the depositor. *Id.* at 2. A time deposit account may be interest-bearing and may be evidenced by a negotiable or non-negotiable, transferable or nontransferable certificate, instrument, passbook, book entry, or other similar instrument. *Id.* As indicated by the definitions in the above-referenced Texas statutes, the presence of an early withdrawal penalty as part of the institution's deposit agreement differentiates time deposit accounts from other types of accounts. *Id.* The most common form of time deposit account is the certificate of deposit.

Questions

Question 1 – Would the SJRA be fully in compliance with the requirements of the PFIA if it deposited \$200,000 of its funds in a time deposit account fully insured by the FDIC?

I believe such a deposit is permitted by the PFIA under either section 2256.010 or section 2259.009(a)(4).

Section 2256.010 states clearly that a certificate of deposit or share certificate is an "authorized investment" under the PFIA if it is issued by a depository institution that has its main office or a branch office in Texas and is guaranteed by the FDIC. Therefore, if this \$200,000 time deposit was made in the form of a \$200,000 certificate of deposit or share certificate insured by the FDIC, it would be a permissible "investment" for the SJRA under the PFIA.

However, given the limitation to "certificates of deposit and share certificates," section 2256.010 may not be broad enough to cover all forms of time deposits. Nonetheless, I believe all forms of time deposits in the amount of \$200,000 would be permitted under section 2256.009(a)(4) of the PFIA as examples of "other obligations, the principal and interest of which are . . . insured by . . . the United States or [its] . . . agencies and instrumentalities, including obligations that are fully guaranteed or insured by the [FDIC]" Such time deposits would be authorized under this provision because (i) they are obligations and (ii) their principal and interest are fully insured by the United States via the FDIC.

Ordinarily, under Texas law, funds placed with a bank, including time deposits, become general deposits owned by the bank and create a legal obligation whereby the bank accepting the deposit is the debtor and the individual or entity making the deposit is the creditor. *See Tex. Bank & Trust Co. v. Spur Sec. Bank*, 705 S.W.2d 349, 352 (Tex. App.—Amarillo 1986, no writ); *Stone Fort Natl. Bank of Nacogdoches v. Forbess*, 126 Tex. 568, 91 S.W.2d 674, 676 (1936). For demand accounts, the title to the money passes to the bank, and the bank impliedly contracts with the depositor that it will repay such money on order of the depositor. *Stone* at 571. In the case of time deposits, some form of agreement between the depositor and bank is executed forming this contract to create the debtor-creditor relationship between the bank and the depositor. *See Tex. Bank & Trust Co.* at 352-353 (citing *Mesquite State Bank v. Professional Investment Corp.*, 488 S.W.2d 73 (Tex. 1972)). Such agreement determines the manner in which the funds of the depositor may be withdrawn and is subject to the law of contracts. *Frost National Bank v. Nicholas and Barrera*, 534 S.W.2d 927 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

The above-described obligation would also be fully insured in accordance with the requirements of section 2256.009(a)(4) of the PFIA. Specifically, so long as the account remained under \$250,000, it would keep FDIC coverage and the obligation would remain fully insured. Act of July 21, 2010, Pub. L. No. 111-203, Section 335(a)(1), 124 Stat. 1376, 1540 (2010).

Question 2 - Would the SJRA be fully in compliance with the requirements of the PFIA and PFCA if it placed \$10,000,000 of its funds in a certificate of deposit backed by a federal home loan bank letter of credit securing the full deposit amount and any accrued interest?

I believe this transaction would meet all applicable requirements of the PFIA and PFCA.

As discussed above, section 2256.010 of the PFIA makes clear that certain certificates of deposit are authorized investments under the PFIA. Of particular relevance here, a certificate of deposit issued by a depository institution that has its main office or a branch office in Texas is an authorized investment under the PFIA if the certificate is secured by an obligation described by section 2256.009(a). TEX. GOV'T CODE ANN. §2256.010(a)(2) (West 2015). Section 2256.009(a)(1) provides that "obligations, including letters of credit, of the United States or its agencies and instrumentalities," are authorized investments under the PFIA. *Id.* §2256.009(a)(1).

Agencies and instrumentalities are not defined in the PFIA or in other Texas statutes. Black's Law Dictionary defines an "agency" as a governmental body with the authority to implement and administer particular legislation. BLACK'S LAW DICTIONARY (8th ed. 2004). It defines a "federal agency" as a department or other instrumentality of the executive branch of the federal government, including a government corporation and the Government Printing Office and an instrumentality as a means or agency through which a function of another entity is accomplished, such as a branch of a governing body. BLACK'S LAW DICTIONARY (8th ed. 2004).

Texas courts have discussed agencies and instrumentalities in another context, the immunity of the United States from taxation by the states. This immunity has been held to extend to the "agenc[ies] or instrumentalit[ies] so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned." *AETC II Privatized Housing, LLC v. Tom Green Cnty. Appraisal Dist.*, 2015 Tex. App. LEXIS 6357 at 8 (quoting *United States v. New Mexico*, 455 U.S. 720, 733 (1982)). In discussing this immunity, the United States Supreme Court has described the nature of a federal instrumentality as "virtually . . . an arm of the Government," "integral parts of [a governmental department]," and "arms of the Government deemed by it essential for the performance of governmental functions." *United States v. New Mexico*, 455 U.S. at 737.

The federal home loan bank system was set up by the Federal Home Loan Bank Act of 1932 as a government enterprise to support mortgage lending and other community investments. P.L. 72-304, 47 Stat. 785; FEDERAL HOUSING FINANCE AGENCY, *The Federal Home Loan Bank System*, <http://www.fhfa.gov/SupervisionRegulation/FederalHomeLoanBanks/Pages/About-FHL-Banks.aspx>. It is composed of eleven regional federal home loan banks, more than 7,300 member financial institutions, and an Office of Finance, as the federal home loan bank system's office of finance. *Id.* Each federal home loan bank is a separate, government-chartered, member-owned corporation. *Id.* As a government-chartered corporation through which government functions are carried out, each federal home loan bank would fit within the definitions of agency or instrumentality discussed above, allowing any of its letters of credit to fit

within the label of obligations of the United States or its agencies and instrumentalities under section 2256.009(a)(1) of the PFIA. Therefore, I believe a certificate of deposit backed by such a federal home loan bank obligation would be permissible under the PFIA.

In order to also be in compliance with the PFCA, the deposit would have to meet the collateral requirements of Section 2257.022. Specifically, there must be a total value of eligible security to secure a deposit of public funds in an amount not less than the amount of the deposit of public funds plus 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. TEX. GOV'T CODE ANN. §2257.022 (West 2015). Section 2257.002(4)(F) explicitly includes "letters of credit issued by a federal home loan bank" as eligible security. *Id.* §2257.002(4)(F).

Since the federal home loan bank letter of credit is large enough to secure the entire amount of the deposit of public funds as well as any accrued interest, I believe it would be a sufficient amount of eligible security to ensure that this investment would be fully in compliance with the PFCA without the SJRA taking any other steps to secure the certificate of deposit with additional collateral.

Question 3 – Would the SJRA be fully in compliance with the requirements of the PFIA and PFCA if it placed \$10,000,000 of its funds in a certificate of deposit backed by a letter of credit from an agency or instrumentality of the United States other than a federal home loan bank in an amount securing the full deposit and any accrued interest?

I believe such a deposit would meet all applicable requirements of the PFIA and PFCA.

An analysis of this deposit would again lead to Section 2256.010 of the PFIA and its designation of certain certificates of deposit as authorized investments under the PFIA. A certificate of deposit issued by a depository institution that has its main office or a branch office in Texas is considered an authorized investment under the PFIA if it is secured by an obligation described by Section 2256.009(a). *Id.* §2256.010. Of particular importance here, section 2256.009(a)(1) provides that "obligations, including letters of credit, of the United States or its agencies and instrumentalities," are authorized investments under the PFIA. The deposit at issue in this question would be backed by a letter of credit from an agency or instrumentality of the United States and, therefore, I believe it would be permissible under the PFIA. *Id.* §2256.009(a)(1).

In order to comply with the PFCA, the deposit would also have to meet the collateral requirements of Section 2257.022. To achieve this, there would have to be a total value of eligible security to secure the deposit of public funds in an amount not less than the amount of the deposit of public funds plus 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. *Id.* §2257.022.

Eligible securities under the PFCA include investment securities. *Id.* §2257.002(4)(F). The definition of investment securities in the PFCA includes securities in which public entities may invest under the PFIA. *Id.* §2257.002(5)(C).

This would mean that since the certificate of deposit is secured by an obligation specifically authorized as an investment in section 2256.009(a)(1) of the PFIA, a letter of credit of an agency or instrumentality of the United States, this deposit would also meet the requirements of the PFCA without taking any further steps to secure the certificate of deposit.

Question 4 – Would the SJRA be fully in compliance with the PFIA and PFCA if it made a \$500,000 money market deposit backed by another obligation listed in Section 2256.009(a), such as a federal home loan bank letter of credit, to the extent the amount of the deposit and any accrued interest exceed the maximum amount of FDIC insurance?

I believe such a money market deposit would be permitted under both the PFIA and PFCA.

In Opinion No. GA-0834, the Attorney General's Office explained that a local government is permitted to place its funds in money market deposit accounts fully backed by the FDIC under the PFIA. Tex. Att'y Gen. Op. No. GA-0834 (2011) at 2. The opinion begins by explaining that a demand account can safely be considered an "other obligation" under section 2256.009(a)(4) since demand deposits represent obligations of the bank to repay the depositor. As such an obligation, it can meet the requirements of the PFIA so long as it is unconditionally guaranteed, insured by, or backed by the full faith and credit of the State of Texas or the United States or their respective agencies and instrumentalities. *Id.* at 1-2. The deposit in question in Opinion No. GA-0834 was fully insured by the FDIC and the opinion explained that it was permissible up to the maximum amount of FDIC insurance, currently \$250,000. *Id.* at 2. However, the issue remains as to whether a demand deposit over the amount of federal coverage provided by the FDIC would be permissible under the PFIA if it were backed by another authorized entity or obligation of such entity.

I believe the deposit at issue in this question would be authorized under the PFIA if the entire amount of the deposit or accrued interest in excess of the \$250,000 insured by the FDIC was backed by an obligation listed in Section 2256.009, such as a letter of credit of an agency or instrumentality of the United States like a federal home loan bank.

This is because the demand deposits are "obligations" as discussed above and the language of section 2256.009(a)(4) permits such obligations under the PFIA so long as they are backed by an agency or instrumentality of the United States, a group that is not limited to just the FDIC. TEX. GOV'T CODE ANN. §2256.009(a)(4) (West 2015). In fact, as noted above, the statute was amended in 2011 to make specific reference to the FDIC in addition to other agencies and instrumentalities of the United States. And so, I believe the backing of a letter of credit from an agency or instrumentality of the United States like a federal home loan bank for the entire

amount over the maximum amount of FDIC insurance would be sufficient to allow this deposit under the PFIA.

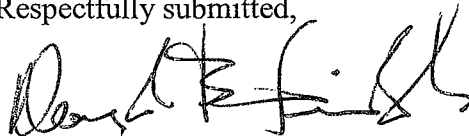
As with the other deposits in question in this request, in order to meet the requirements of the PFCA, the deposit would also have to meet the collateral requirements of section 2257.022. To meet these requirements, there must be a total value of eligible security to secure the deposit of public funds in an amount not less than the amount of the deposit of public funds plus 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. *Id.* §2257.022. Using the logic described in the discussion of Question 3, eligible securities include securities in which a public entity may invest under the PFIA. *Id.* §§2257.002(4)(F) and 2257.002(5)(C).

This would mean that since the money market account would be secured for any amount over the maximum amount of FDIC insurance by an obligation specifically authorized as an investment in Section 2256.009 of the PFIA, a letter of credit of an agency or instrumentality of the United States, it would meet the requirements of the PFCA without taking any further steps to secure the account.

Therefore, I believe this money market deposit backed by the FDIC up to \$250,000 and backed by a federal home loan bank letter of credit for any deposit or accrued interest amount above \$250,000 would be permissible under the PFIA and PFCA.

I seek your opinion on all four of these questions. Thank you for your time and attention to these important issues concerning public funds.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Lloyd B. Tisdale", written in a cursive style.

Lloyd B. Tisdale
President, Board of Directors
San Jacinto River Authority