A Resolution Providing Guidance on Debt Term Limits for Units of Local Government and Public Authorities

WHEREAS, the Local Government Commission ("LGC") approves individual terms of debt maturity and issues debt for units of local government and public authorities (hereinafter collectively "Units") pursuant to legislative mandate set forth in GS Chapter 159; and

WHEREAS, the State and Local Government Finance Division ("SLGFD") provides staff support to the LGC, and assists it by exercising comprehensive financial oversight of North Carolina's Units, reviewing applications for debt to be issued by Units and making recommendations to the LGC on such applications; and

WHEREAS, LGC desires to provide written guidance to Units when preparing applications for debt, and to its staff when evaluating and recommending applications for the issuance of debt by Units; and

WHEREAS, the LGC desires that its staff apply these guidelines consistently when reviewing such debt applications, taking into account individual circumstances when appropriate; and

WHEREAS, the LGC recognizes that debt levels and their related annual costs are important long-term obligations that must be managed within available resources; and

WHEREAS, the LGC understands that the decision to issue long-term debt involves recognition that public finance best practices categorize capital investments as expenditures that will benefit future generations. An asset will have a useful life that spans generations, providing benefits that those generations should help finance, but such financing should not become a burden on future generations beyond the useful life of the asset. Accordingly, the term of the debt should relate to the useful life of the asset being financed. The debt structure should provide for repayment of the debt in a timeframe that is less than or meets the useful life of the asset. This provides cushion at the end of the term to meet cash flow needs for maintenance and repair in the asset's final days.

WHEREAS, the LGC believes that a conservative approach to debt issuance allows a Unit to properly manage its debt load so that future generations are not burdened with payments on capital assets beyond the time that those assets are providing benefits; and

WHEREAS, this conservative approach to fiscal policy has resulted in North Carolina's Unit debt receiving consistently positive ratings from the ratings agencies; and

WHEREAS, pursuant to GS §159-122(c), an asset's useful life shall not extend beyond forty (40) years. Moreover, since 1976, the LGC has utilized a schedule of useful lives of capital projects as set forth in 20 NCAC 03 .0305; and

WHEREAS, the LGC looked to its enabling statute and administrative rules, commonly accepted depreciation schedules, the ratings agencies, government accounting professional associations and their promulgated standards, best practices for debt management in the finance industry, and the expertise of its own staff in formulating these guidelines. The resulting approach is a conservative one that LGC encourages Units to embrace by incorporating them into their own written debt management policies; and

WHEREAS, determining the appropriate debt structure also depends on the Unit's credit quality. Calculating the appropriate structure requires balancing the interest rate needs of the Unit, the higher borrowing rates and financing costs incurred by borrowing for a longer period, a Unit's credit history and rating, and the quality of the debt instrument; and

WHEREAS, the initial maturity schedule should also be conservative enough to enable the Unit, under statutory limits, to extend the repayment period should severe unforeseeable loss of revenues or additional expenditures occur. In keeping with conservative debt management principles, the goal of each debt issuance should be to make the debt affordable so that the Unit can responsibly meet its capital needs while getting itself out of debt and rebuilding its cash reserves as quickly as possible; and

WHEREAS, in the case of financings by the United States Department of Agriculture ("USDA"), LGC recognizes that the Unit made use of the financing because its financial circumstances required a prolonged term to pay for a currently essential acquisition. The USDA typically allows terms up to forty (40) years and applies additional oversight to determine that the funds advanced are reasonable in terms of probable repayment, and that the financing plan is reasonable. In the event of problems with re-payment, the USDA is more likely to extend forbearance and attempt to accommodate the Unit to prevent a cataclysmic financial event. In the event of favorable financial developments, the Unit may prepay without penalty as much as it deems prudent. This flexible and hands-on debt management approach stems from the USDA's interest in the public well-being and its mission to provide essential community facilities in rural and low-wealth areas, and is beyond what is expected or extended by the general debt market. While USDA installment purchase financings *do not* require LGC approval, a refinancing to another type of debt instrument might.

NOW, THEREFORE, the LGC resolves that in addition to the bond maturities and capital project useful lives established by general statute and administrative rule, the following guidelines shall be used by its staff and itself when evaluating requests for the issuance of debt by Units. These guidelines shall be applied to all applications, but may be varied on a case-by-case basis in the discretion of the LGC and its staff:

1. For General Obligation Bonds, the normal maturity will be twenty (20) years or less, with exceptions for special circumstances or needs, and a requirement of even principal payments annually so that approximately one-half of total principal will be repaid within ten (10) years. Some flexibility may be allowed at the beginning of a term to allow blending with the existing debt service schedule of the Unit. In no case should the term allowed exceed the expected useful life of the asset being financed.

2. For Installment Purchase Contracts and Certificates of Participation (Limited Obligation Bonds) under GS 160A-20, the normal maturity will be twenty (20) years or less with a requirement of level principal payments for governmental activities so that approximately one-half of total principal will be repaid within ten (10) years. Level annual payments may be permitted for debt issued to acquire assets supported by user fees so that customer charges may remain fairly constant from year to year. Some exceptions may be appropriate for larger projects with an asset life extending beyond twenty (20) years such as parking facilities.

3. For Revenue Bonds, the normal maturity shall be between twenty (20) and twenty-five (25) years depending on the life of the asset, with some exceptions for large enterprise financings with longer asset lives. For revenue bonds, the normal bond structure contemplates level annual payments to reflect the normally level stream of revenues generated by the project. With even annual payments, principal payments are initially smaller and increase gradually over the term of the financing much like a home mortgage amortization. Sometimes an exception might be in order to allow a term of thirty (30) to forty (40) years for projects where the asset financed has a longer useful life, such as a nuclear power facility.

4. For Refunded debt, the expectation is that net present value savings from the refunding will be at least three percent (3%) of the amount of bonds or debt refunded. There should be no extension of maturities, and level annual savings. In no event should an original term combined with a refunded term exceed forty (40) years.

5. For Restructured debt, the Unit must be experiencing severe, unforeseeable loss of revenues or additional expenditures. In no event should an original term combined with a restructured term exceed forty (40) years.

6. For USDA refinancing, the Unit has concluded that the USDA terms are no longer advantageous or necessary for the Unit to achieve its capital improvement goals. When the USDA loan is refinanced with a conventional tax-exempt loan, it should be placed on a conventional footing from the date of the original loan in relation to the remaining term. The Unit should have the capacity to make level principal payments and to pay the balance of the loan over the remnant of the period of twenty (20) to thirty (30) years from the date of the original loan. The savings to the Unit should be due primarily to actual interest rate-created savings as opposed to solely cash savings realized by shortening up the term. In no event should an original term combined with a refinanced term exceed forty (40) years.

7. This Resolution shall be effective immediately upon its adoption.