

North Carolina Public Finance

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Local Governments in North Carolina incur debt only to finance capital costs

- Assets are paid for as they are used (with the debt paid more quickly than the useful life of the property financed)
- No financing of Operating Costs is permitted

North Carolina Local Government Commission

- Nearly all local government financings are subject to approval by the Local Government Commission
- Very narrow exceptions for short-term (less than 5 year) equipment financings
- Unusual arrangement—in most states there is no state level oversight of local government borrowings

LGC oversight is viewed favorably by the market

- North Carolina has one of the highest number of triple-A rated local governments in the country
- Rating Agencies have affirmed the value of LGC oversight
- Most of the local governments that have ratings have A or better credit ratings
- North Carolina has many double-AA municipal credits

LGC policy prohibits the public sale of any local government debt not rated at least an investment grade rating (BBB)

- Unrated debt or non-investment grade debt can only be sold to banks, insurance companies and qualified institutional buyers who make their own credit analysis
- This standard discourages the use of local government debt for speculative projects

Public Input in Local Government Financings

- Voted General Obligation Bonds Require a Public Hearing and a Vote of the People
 - Authorization of Voted General Obligation Bonds entails publication of five separate notices in local newspaper
 - Authorization of Non-Voted General Obligation Bonds requires public hearing, except a refunding for savings that does not extend the Bond maturity, and two publications
- Installment financing contracts require public hearing, following publication of notice
- All bond or other financing authorizations are conducted at public meetings in open session
- Almost all financings are subject to LGC approval

Derivatives

- Almost none have been done since 2008
- State Law permits only very limited use of such instruments, and only by highly rated credits
- Derivatives typically used only to swap from a floating rate to a fixed rate, or to cap the floating rate
- Opinion of independent swap advisor required by LGC for all local government derivatives
- All derivatives are required by statute to be approved by the LGC

Municipal Bonds in the News

- Nationally, there is not any major issuer that has incurred financial crisis solely on account of its conventional debt
- The main culprits have been unfunded pension obligations and liabilities associated with derivatives
- In North Carolina, the LGC has responsibility for fiscal management of local governments
 - LGC has power to detect problems as they arise and to intervene to find a solution before a default occurs; can actually take charge of all financial affairs of a local government, if necessary
 - North Carolina local governments can only file for bankruptcy protection with the approval of the LGC
 - Many of the defaults nationally have been from special district bond issues of typically unrated debt to be paid from property taxes that were dependent upon future development

Other types of public finance in North Carolina – Conduit Financings

- Federal tax law provides incentives for certain types of issuances by governmental entities for the benefit of private parties
 - Small manufacturing facilities (industrial development bonds)
 - Nonprofit hospitals, schools (including charter schools), colleges
 - Other nonprofits such as YMCAs
 - Affordable housing
- Bonds are usually issued by special purpose pass-through authorities with no assets (called “conduit issuers”)
- Conduit issuers have no obligation to repay the debt; only the private party is responsible
- NO public dollars or credit is involved
- Most conduit financings subject to LGC review
- LGC has high standard for when these bonds may be issued and who may own them

Tax-Exempt Private Activity Bonds

“Public” Financing through Private Activity Bonds

-- County industrial facility and pollution control financing authority or the North Carolina Capital Facilities Finance Agency issues bonds at a tax-exempt rate, lends the proceeds to a private company for certain purposes authorized by Internal Revenue Code and North Carolina law

- Credit of State and county not pledged
- Allows private company to borrow at lower tax-exempt interest rate
- Interest on income from bonds exempt from federal and North Carolina income taxes

Private Activity Bonds (cont'd)

- Industrial development bonds: allows tax exempt financing of manufacturing facilities (up to \$10 million);
- Exempt facility bonds: allows tax exempt financing of specific types of privately owned property
 - Privately owned water service
 - Solid waste disposal
 - Airports
 - Private projects at public ports
- 501(c)(3) bonds for nonprofit entities
 - Nonprofit K-12 schools, including charter schools
 - Nonprofit colleges and universities
 - Nonprofit health care facilities
 - YMCAs, museums, charities such as Interact, Mental Health Association, Hospice

Special Purpose Districts

- North Carolina law provides for several types of special purpose districts (i.e. tax increment financing (TIF) districts and special assessment districts)
 - Debt is issued to finance infrastructure with repayment expected from increased taxes or special assessment levied on the property in the district
 - North Carolina has been very careful and conservative in the use of this tool
 - LGC has significant oversight over formation of and issuances by special purpose districts

PPPs in North Carolina public finance

- PPP refers to a wide range of relationships between the public and the private sector
- Generally viewed as an arrangement by which the private sector develops, builds, finances, and/or operates public projects
- Although private sector may undertake the project, and even provide the initial financing, the credit of the public body is ultimately the source of repayment, either through payments on a lease of the project or by purchasing it once built

PPP Structure in North Carolina

- PPPs in development and operation of revenue generating assets
 - Water and sewer systems
 - Solid waste disposal systems
 - Toll roads and bridges
- PPPs in development and operation of public assets
 - Jails
 - Public parking decks
 - Convention Center/Hotel
 - Schools
 - Stadiums

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