Buncombe County Debt Policy

Original Effective Date:	06-18-96
Dates of Revision:	08-07-12

Purpose

The debt policy establishes parameters for issuing and managing debt to meet capital needs for essential county services to citizens. The scope of this policy includes debt issued and managed by the County for the capital needs of Buncombe County Schools, Asheville City Schools, Asheville-Buncombe Technical Community College, and the Woodfin Downtown District. It is designed to provide financial flexibility by ensuring future capacity in order to take advantage of potential future savings opportunities.

Debt is issued in accordance with North Carolina General Statutes (NCGS) 160A-19, 160A-20 and 153A-165, and under the guidance and approval of the Local Government Commission, a division of the North Carolina State Treasurer, Buncombe County recognizes that a formally adopted local debt policy is an essential financial management tool and is fundamental to:

- Ensure fiscal prudence and promote financial sustainability;
- Document the decision-making process and enhance the quality of decisions;
- Identify objectives for staff to implement; and
- Demonstrate to investors and rating agencies that the County is dedicated to sound financial management.

It is the objective of the policy that:

- The county obtain financing only when necessary;
- The process for identifying the timing and amount of debt or other financing be as efficient as possible;
- The most favorable interest rate and other related costs be obtained, and
- The credit rating of the County is protected.

Both the Government Finance Officers Association (GFOA) and bond rating agencies strongly encourage the development of a formal debt policy.

Administration and Implementation

Per NCGS 159-36 “the Governing Board shall enact a budget ordinance levying the necessary taxes or allocating the necessary revenue to meet all installments of principal and interest falling due on its debt during the budget year.”

The County Manager and Finance Director are charged with carrying out the policy. The Finance Director is responsible for developing recommendations for debt financing. In addition, per NCGS 159-24, the Finance Director “shall maintain all records concerning the bonded debt and other obligations of the local government . . . and determine the amount of money that will be required for debt service or the payment of other obligations during each fiscal year . . .”

The debt policy is to be used in conjunction with the operating and capital budgets, the Capital Improvement Program (CIP), and other financial policies.

The County will evaluate this policy at least every five (5) years.

Conditions for Issuance of Debt

The following standards help determine if debt is an appropriate option as circumstances change over time.

- **Favorable market conditions -** The County will strongly consider debt issuance, rather than paying cash, when interest rates are low and/or when construction costs are low or are projected to increase.
- **Favorable financial ratios -** See “Financial Limitations” beginning on page 5 of this policy.
- **Distribute costs and benefits appropriately -** Debt will be used to distribute the payments for an asset over its useful life so that benefits more closely match costs and the type of debt instrument will be chosen to help distribute public and private benefits appropriately.
- **Investment-grade bond ratings -** The particular project being funded will support an investment-grade credit rating.
- **Project characteristics support use of debt -** The County may issue debt for the purpose of acquiring or constructing capital assets including land, buildings, machinery, equipment, furniture and fixtures.

- **Minimum useful life -** Long-term debt will be issued to purchase or construct capital improvements or equipment with a minimum expected life of five years.
- **Resources adequate to cover debt service -** Long-term revenue and expenditure forecasts will support the assumption the government will be able to repay any debt without causing financial distress. Other non-financial factors such as population and property could influence the government's ability to service its debt over the long term and will be projected and taken into consideration.
- **Resources adequate to cover operating and maintenance costs** - Debt may be considered for maintenance projects that expand an asset's capacity or significantly extends it useful life; otherwise, the County will consider these costs when developing the capital improvement plan and a strategy developed to absorb these costs into the operating budget.

Annually, the County will prepare and adopt a Capital Improvement Program (CIP) to identify and establish an orderly plan to meet the County's infrastructure needs. The CIP will also identify all debt-funded projects and the related debt service impact covering at least five (5) years.

Permissible Debt Instruments

- **General Obligation Bonds** are bonds secured by a promise to levy taxes in an amount necessary to pay debt service, principal and interest, coming due each fiscal year. General obligations bonds are backed by the full faith and credit of the County. These bonds are authorized by a referendum or by non-voted two-thirds (2/3's) authorization by the governing body. The non-voted authorization allows governments to issue up to two-thirds of the previous year's general obligation net debt reduction without a referendum.
- **Revenue Bonds** are a pledge of the revenues generated by the debt financed asset or by the operating system of which that asset is a part.
- **Special Obligation Bonds** are bonds that are payable from the pledge of any revenues other than locally levied taxes.
- **Certificates of Participation (COPs)/Limited Obligation Bonds (LOBs)** are an alternative financing method that does not require voter approval. These certificates/bonds represent an undivided interest in the payments made by a public agency pursuant to a financing lease or an installment purchase agreement. The security for this financing is represented by a lien on the property acquired or constructed.

- **An Installment Purchase Contract** is an agreement in which the equipment or property is acquired and periodic payments, which are sufficient to pay debt service, are made.

Restrictions on Debt Issuance

It is the goal of the County to fund current services with current resources so a burden is not passed on to future taxpayers. This also assures future generations are not paying for an asset without benefiting from it, therefore:

- Long-term debt shall not be used to finance ongoing operational expenses;
- Long-debt will not be amortized for a period beyond the life of the asset it is financing;
- An analysis of all debt options for the size of issuance will be completed to ensure the most cost efficient method of issuing and managing bonds is chosen;
- The County will limit the ratio of variable rate debt to fifteen percent (15%) of the total outstanding debt.
- The County will adhere to all legally authorized debt limits and tax or expenditure ceilings as well as coverage requirements and additional bond tests imposed by bond covenants.
- Pay-as-you-go financing (also known as *cash* or *PayGo* financing) uses current resources, such as current tax dollars or accumulated reserves, to purchase a capital asset. This can be justified on the grounds of keeping the community's debt burden down thereby preserving flexibility and because the net benefits derived from the asset are likely to be greater during the early years of its life, before maintenance costs begin to rise.

Financial Limitations

Per NCGS 159-55, net debt shall not exceed eight percent (8%) of the appraised value of property subject to taxation. However, local policy places the following additional restrictions and guidance on the use of debt financing and debt structuring beyond the terms of the General Statutes:

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Ratio	Definition	Restriction
Net Direct Debt Per Capita	Measures the burden of debt placed on the size of the population supporting the debt and is widely used by rating analysts as a measure of an issuers' ability to repay debt.	Not to exceed $1,200
Net Direct Debt as a Percentage of Assessed Valuation	Measures debt levels against the property tax base which generates the tax revenues that are the main source of debt repayment.	Less than 3%
Net Direct Debt Service as a Percentage of Total Governmental Fund Expenditures	Measures the budgetary flexibility government-wide to adapt spending levels and respond to economic condition changes.	Not to exceed 10%
Net Debt Service as a Percentage of Total General Fund Expenditures	Measures the budgetary flexibility of the general fund to adapt spending levels and respond to economic condition changes.	Less than 8%
Payout of Total Outstanding Debt Principal	Measures speed at which the County's outstanding debt is amortized.	Greater than or equal to 65% in 10 years
Outstanding Variable Rate Debt as a Percentage of Total Outstanding Debt	Measures the amount of variable rate debt to which the debt portfolio is exposed.	Not to exceed 15%

Net direct debt is debt supported by general revenue and taxes less resources restricted for debt service.

Target debt ratios will be annually calculated, comparisons made to “like” Counties in North Carolina, in conjunction with the capital budget process, the annual financial audit and as needed for fiscal analysis. In developing the benchmark group, the County will look for similarities along key dimensions like:

- Level of urbanization
- Population size
- Economy
- Geography and weather
- Demographics, such as age and income
- Total general fund revenues and expenditures
- Revenue mix and diversity
- Scope of services delivered
- Form of government
- Bond Rating

Structuring Practices

The life of the debt, interest mode and principal maturity schedule make up the structure of the debt.

- **Maturity Guidelines** - Debt will be paid off in a timeframe that is less than or equal to the useful life of the asset or project acquired through the financing.
- **Debt Service Schedule** - County debts will be amortized for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users of assets financed by the debt. Further, debt capacity should not be tied up servicing a defunct asset. It is the goal of the County to amortize all debt issuances within twenty (20) years or less.
- **Level Principal Payments** - Debt service for each issue will be structured in an attempt to level out the county's principal debt service payments over the life of the debt portfolio. This structuring will assist in minimizing the interest payments over the life of the issue. The use of these techniques will be evaluated based on market conditions and the maximum benefit to the County while minimizing risk.

- **Credit enhancements** are financial instruments that provide additional assurances to investors in the form of an added source of security for bond payments. These may be a letter of credit from a bank, bond insurance or surety policy and will be used only when the cost of the enhancement will result in a net decrease in borrowing costs or provide other significant benefits (e.g., make the bonds easier to sell).
- **Redemption features** give the County the right to prepay or retire debt prior to its stated maturity. These features may be a call option or optional redemption provision and permit the County to achieve interest savings by refunding bonds early. Redemption features require constant monitoring and cost-benefit analysis and will be used only when the potential to reduce the cost of borrowing is present as evaluated on the following factors:
  - The call premium required.
  - Level of rates relative to historical standards.
  - The time until the bonds may be called at a premium or at par.
  - Interest rate volatility.
- **Capitalized Interest** is the practice of using bond proceeds to pay the interest due on debt during the construction period of an asset. Capitalization of interest will never exceed the time necessary to construct the asset.
- **Pool Projects** - when feasible, debt issuance will be pooled together to minimize issuance expense.

Debt Issuance Process

All long-term financing shall comply with federal, state, and local legal requirements and the Board of Commissioners will approve each issue.

- **Method of Sale -** The County will use the following methods to sale bonds and installment purchase transactions:
  - **Fixed rate general obligation bond sales** are conducted on a competitive basis by the Local Government Commission (LGC), a division of the Office of the State Treasurer.
  - **COPs/LOBs, variable rate bonds, revenue and special obligation bonds** will be sold on a negotiated basis.

- **Reimbursement Resolution** - If the cash requirements for capital projects are minimal in any given year, the County may choose not to issue debt. Instead, the County may adopt a reimbursement resolution, then fund up-front project costs and reimburse these costs when financing is arranged.

Professional Service Providers

- **Financial Advisor –**These duties include identifying capital financing alternatives and planning the debt program, working with other members of the financing team to determine the structure and timing of the issues, preparing bond documents and rating agency presentations. The Finance Director and staff can perform these duties, or can contract any or all financial advisory services if desired. The Financial Advisor should be independent of the Underwriter.
- **Bond Counsel –** The primary role of the Bond Counsel is to certify the issue has legal authority to issue the bonds and the securities qualify for federal and state income tax exemption. Bond Counsel drafts bond documents including the official statement, ordinances and resolutions authorizing issuance and sale of a bond offering, and other necessary documents. Bond Counsel firms will be chosen based on experience in the area of municipal bonds and will be compensated on a negotiated fixed-fee basis.
- **Underwriter –** the primary function of the underwriter is to purchase securities from the County and resell them to investors. Underwriters will be selected for each issue based on the particular experience and expertise necessary for that issue. The underwriter’s compensation (an “underwriter’s discount”) is a percentage of the amount of bonds sold and is negotiated for each issuance. When the amount of bonds to be issued exceeds twenty million dollars ($20 million) the LGC requires a Co-Manager Underwriting firm in addition to the primary Underwriting firm (Senior Managing Underwriter). Underwriter’s employ their own Counsel.
- **Trustee –** The Trustee receives funds from the County and makes payments to bondholders, maintains records of bond ownership and acts as fiduciary agent for the benefit of the bondholders in enforcing the terms of the bond contract.

Debt Management Process

- **Investment of Debt Proceeds –** Debt proceeds can be invested before they are spent on acquiring or constructing the assets they were issued to finance.
- **Arbitrage -** Typically, proceeds can be invested in instruments allowed for general government investments under NCGS. However, the one major difference specific to tax-exempt bond proceeds is that of arbitrage limits. Limits apply to interest earnings on funds received from the issuance of tax-exempt bonds, and where and when the proceeds are spent. The Finance Director, or designee, is to manage the investment of debt proceeds in order to minimize arbitrage liability and avoid penalties and protect the tax-exempt status.
- **Compliance Practices -** The County will monitor and comply with all requirements issued by the Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) and file required documents in a timely manner.
- **Separate Accounts -** Debt proceeds are to be invested in accounts separate from general idle cash.
- **Refunding Bonds** is the practice of selling bonds to refinance outstanding bonds. The County will monitor the debt portfolio for refunding opportunities for any of the following reasons:
    - Interest rate savings.
    - Restructuring debt service schedule.
    - Restructure other compliance requirements.
- **Market and Investor Relations -** A policy of full and open disclosure on every financial report and long-term obligation transaction will be enforced. A credit rating agency presentation/update shall be conducted at least bi-annually.
- **Credit Rating Goals -** The County will manage in a way to obtain the highest credit rating possible and seek ratings from two (2) agencies.

Special Situations

- **Use of Derivatives -** A derivative is a financial instrument whose value depends on other, more basic underlying variables. Derivatives may take the form of interest rate swaps; futures and options contracts; options on swaps; and other hedging mechanisms such as caps, floors, collars, and rate locks. Derivatives can provide interest rate savings, alter debt service patterns, and provide a hedge against risk associated with variable interest rate debt. However, derivatives also come with multiple risks that currently outweigh the benefits. The County believes capital objectives can be accomplished with traditional and more conservative financing methods and therefore prohibits the use of derivatives.
- **Interfund Borrowing** is considered a loan and repayment is necessary.
  - The County Manager and the Finance Director are authorized to approve interfund borrowings for cash flow purposes whenever the cash shortfall is expected to be resolved within 90 days.
  - Any other Interfund borrowings for cash flow or other purposes require approval by the Board of Commissioners.
  - Any transfers between funds where reimbursement is not expected within one fiscal year shall not be recorded as interfund borrowings. They shall be recorded as interfund operating transfers.
  - The fund receiving the loan shall repay the fund providing the loan on a level or accelerated repayment schedule at a prevailing rate of interest set by the Finance Department.
- **Variable Rate Debt (VRD)** does not have a set or fixed long-term interest rate, but rather has an interest rate that varies over the life of the debt based on prevailing market interest rates at the time. Financial market disruptions have increased the County’s wariness of variable rate debt due to interest rate, budgetary, repayment and political risk; however, VRD has traditionally represented an opportunity to make more effective use of tax dollars by lowering the cost of financing long-term capital assets. Therefore, staff is directed to forecast interest rate volatility over the short and long terms and expected performance of selected financial products under various interest rate scenarios and consider VRD when interest rates are dropping. Interest payments on VRD will be budgeted at the prevailing rate for fixed-rate debt and the interest savings will be used to pay down debt more quickly if permissible within the terms of the debt issuance.

- **Project Development Financing (PDF) -** The North Carolina State Treasurer advises there is not a market for this type of debt in the current environment; therefore, it is excluded from the County's permissible debt instruments.[1]
- **Short-term debt -** may be used by the County for three (3) primary purposes:
  - To cover a gap in financing when capital projects begin before long-term bond proceeds have been received.
  - To take advantage of variable interest rates.
  - To finance short-lived assets such as vehicles.
- **Leases -** most appropriate for smaller borrowings mainly because of the low cost of issuance. Leases may be used by the County for assets that cost over $200,000 and have a useful life that equals or exceeds three years.
- **Alternative financing products -** Products such as direct lending by banks are particularly useful for short-term financing needs and may have a variable rate. Covenants that could lead to acceleration of repayment are prohibited and the debt may not be transferred or sold to a third party.

[1] The County currently has outstanding PDF Debt for the Woodfin Downtown District.