



## ROCKINGHAM COUNTY DEBT POLICY

Adopted: June 15, 2015

### AUTHORITY

The Chairman and the Board of County Commissioners are responsible for legislation, policy formulation, and overall direction setting of the government. This includes the approval of financial policies which establish and direct the operations of Rockingham County. The County Manager is responsible for carrying out the policy directives of the Board of Commissioners and managing the day-to-day operations of the county departments.

### 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 Rockingham County, Rockingham County Schools and Rockingham County Community College. 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 guidance and approval of the Local Government Commission, a division of the North Carolina State Treasurer, Rockingham 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 159-13(b) "The following directions and limitation shall bind the governing board in adopting the budget ordinance: NCGS 159-13(b)(1) "The full amount estimated by the finance officer to be required for debt service during the budget year shall be appropriated."

The County Manager and Financial Services Director are charged with carrying out the policy. The Financial Services Director is responsible for developing recommendations for debt financing. In addition, per NCGS 159-25(5), the Financial Services Director "shall maintain all records concerning the bonded debt and other obligations of the local government or public authority, determine the amount of money that will be required for debt service or the payment of other obligations during each fiscal year, and maintain all sinking funds".

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

The County will evaluate this policy at least every five (5) years and more frequently if warranted due to changes in economic conditions.

## 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 ratio** – See "Financial Limitations" beginning on page 4 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 its 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 Plan (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

The following debt instruments are permissible for Rockingham County:

- ❖ **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 obligation 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.
- ❖ **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.
- ❖ **Guaranteed Energy Savings Contract** NCGS 143-64-17 defines this as a contract for the evaluation, recommendation, or implementation of energy conservation measures, including the design and installation of equipment or the repair or replacement of existing equipment or meters, in which all payments, except obligations on termination of the contract before its expiration, are to be made over time, and in which energy savings are guaranteed to exceed costs. The energy conservation measures to be installed are for an existing building or utility system and the term of the contract may not exceed 20 years from the date of the installation and acceptance of the energy conservation measures provided for under the contract. Per NCGS 143-64.171 "a local governmental unit may provide for the acquisition, installation, or maintenance of energy conservation measures acquired...by installment or lease purchase contracts in accordance with and subject to the provisions of NCGS 160A-19 and 160A-20, as applicable.

## 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-term 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 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(c), 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:

- ❖ **Net Direct Debt (*debt supported by general revenue and taxes less resources restricted for debt service*) as a Percentage of Assessed Valuation** below 3%.
- ❖ **Net Direct Debt Per Capita** will not exceed \$1,200.
- ❖ **Net Direct Debt Service as a Percentage of Total Governmental Fund Noncapital Expenditures** will not exceed 15%.
- ❖ **Payout of Total Outstanding Debt Principal** will strive to achieve amortization of 65% or more within 10 years.

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

- ❖ Population size
- ❖ Total General fund revenues and expenditures
- ❖ Level of urbanization
- ❖ Economy
- ❖ Geography
- ❖ Demographics, such as age and income
- ❖ Revenue mix and diversity
- ❖ 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 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 transaction:
  - **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, 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 Financial Services 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**

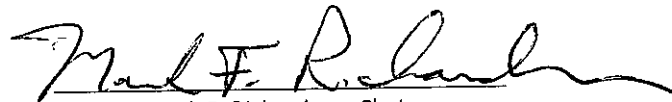
- ❖ **Investment of Debt Proceeds** – Debt proceeds can be invested before they are spent on acquiring or constructing the assets they were issued to finance.
- ❖ **Arbitrage** – Typically, proceeds can be invested in instruments allowed for general government investments under NCGS. However, the one 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 Financial Services 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.
- ❖ **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**

- ❖ **Inter-fund Borrowing** is considered a loan and repayment is necessary.
  - The County Manager and the Finance Director are authorized to approve inter-fund borrowings for cash flow purposes whenever the cash shortfall is expected to be resolved within 90 days.
  - Any other Inter-fund borrowings for cash flow or other purposes require approval by the Board of Commissioners.
  - Any transfer between funds where reimbursement is not expected within one fiscal year shall not be recorded as inter-fund borrowings. They shall be recorded as inter-fund operating transfers.

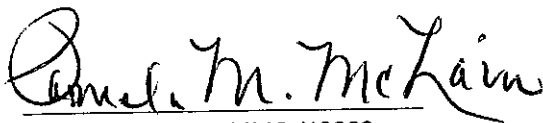
- The fund receiving the loan shall repay the fund providing the loan on a level or accelerated repayment schedule at a prevailing rate of interest set by the Finance Department.
- ❖ **Short-term debt** – may be used by the County for two (2) primary purposes:
  - To cover a gap in financing when capital projects begin before long-term bond proceeds have been received.
  - To finance short-lived assets such as vehicles.
- ❖ **Leases** – may be used for smaller borrowings and are advantageous due to the low cost of issuance. Leases may be used by the County for assets that have a useful life that equals or exceeds three years.
- ❖ **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.**
- ❖ **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 and volatility increase the interest rate risk as well as increase budgetary and repayment concerns. **Therefore, Variable Rate Debt is excluded from the County's permissible debt instruments.**
- ❖ **Alternative financing products** – Products such as direct lending by banks are particularly useful for short-term financing needs. Covenants that could lead to acceleration of repayment are prohibited and the debt may not be transferred or sold to a third party.

Adopted this 15 day of June, 2015



Mark F. Richardson, Chairman  
Rockingham County Board of Commissioners

Attest:



Pamela M. McLain, MMC, NCCCC  
Clerk to the Board

