Introduction

New Hanover County recognizes that a formal debt policy is essential to effective financial management. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and, therefore, is likely to meet its debt obligations in a timely manner and is also a recommended practice of the Government Finance Officers Association. Debt management policies are written guidelines, allowances, and restrictions that guide the debt issuance practices. Adherence to a debt policy helps to ensure that a government maintains a sound financial position and that credit quality is protected.

Many of the processes for approval, sale, and repayment of debt are controlled by North Carolina statutes and regulations and may not all be repeated within this policy. This debt policy is to be used in conjunction with those laws and regulations and with the operating and capital budgets and other financial policies. Objectives of the debt policy have been set to assist the County in retaining its bond ratings and include:

-Funding a Capital Improvement Plan
-Maintaining an appropriate mix of pay-as-you-go and debt funding
-Maintaining an adequate fund balance, including an appropriate amount of unassigned fund balance
-Structuring debt repayment schedules that observers expect of Aaa/AAA counties

Debt Instruments

The County will use appropriate debt instruments to provide funding for capital assets at the lowest cost with minimal risk:

General Obligation Bonds:

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 (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 net debt reduction without a referendum.

Revenue and Special Obligation Bonds:

Revenue bonds are bonds that pledge 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 revenues other than locally levied taxes.

Other Financing Arrangements:

Installment financings are an alternative financing method that does not require voter approval. Certificates of participation or limited obligation 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. The County will use this type of financing for short-term equipment purchases of 3 to 5 years.

The County will use pay-as-you-go funding for capital improvements or capital assets having a cost of less than $250,000 or assets having a useful life of less than 10 years unless budgetary restraints require the use of financing to acquire the necessary funding for those capital improvement or capital assets.

Purposes for Debt Issuance

The County may issue debt for the purpose of acquiring or constructing capital assets including land, buildings, machinery, equipment, fixtures and any other eligible expenses of the project and for making major renovations to existing capital improvements, for the good of the public. Exceptions to this rule will be considered on a case-by-case basis to determine if the contemplated debt is in the best interests of the County. Long-term debt shall not be used to finance ongoing operational expenses. When applicable, debt issuance will be pooled together to minimize issuance expense.

Before issuing any new debt the County will consider the following factors:

-Global, national and local financial environment and economy
-Current interest rates and expected interest rate changes
-Cash position and current debt position
-Availability of funds to repay
-Urgency of current capital needs and flexibility to cover future needs
-Appropriate debt issuance practices and debt structuring

Debt Structure

The debt structure is made up of the life of the debt, interest rate and principal maturity schedule. This debt could be general obligation, revenue or special obligation bonds, or other installment financings. The cost of taxable debt is higher than the cost of tax-exempt debt. However, the issuance of taxable debt is mandated in some circumstances, and may allow flexibility in subsequent contracts with users or managers of the improvements constructed with the bond proceeds. The County will usually issue obligations on a tax-exempt basis, but may occasionally issue taxable obligations when there is an expected benefit from doing so. The County shall establish an affordable debt level to preserve credit quality and ensure sufficient revenue is available to pay annual debt service.

General obligation bonds will generally be competitively bid with no more than a 20-year life unless there are compelling factors which make it necessary to extend beyond this point and applicable law allows a longer term. In a competitive sale, the County may sell its debt obligations in which any interested underwriter or syndicate is invited to submit a proposal to purchase an issue of bonds. The bonds are awarded to the underwriter presenting the best bid according to stipulated criteria set forth in the notice of sale.

Negotiated sales or private placements, however, may be used where allowed when complex financing or sales structure is a concern with regard to marketability. In a negotiated sale, the bonds may be sold through an exclusive arrangement between the County and an underwriter or underwriting syndicate. At the end of successful negotiations, the issue is awarded to the underwriters. This method offers flexibility for the County. The criteria used to select an underwriter or syndicate in negotiated sales should include, but not be limited to the following: overall experience, marketing philosophy, capability, previous experience, underwriter's discount, and expenses.

The County may elect to sells its debt obligations through a private placement when appropriate. Selection through private placement shall be determined through the Requests for Proposal (RFP) process.

Debt service for each issue will be structured in an attempt to minimize the County's interest payments over the life of the issue while taking into account the existing debt obligations of the County. Any debt issued shall not have a maturity date beyond the useful life of the asset being acquired or constructed by the debt proceeds.

The County may also consider various financing methods including fixed or variable interest rate debt in order to minimize the interest costs over the life of the issue. The use of these methods will be evaluated based on market conditions and the maximum benefit to the County while minimizing the County's risk. When appropriate, the County may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities or reset date determined by the bondholder. The County will limit the issuance of variable rate debt to help maintain the County's Aaa credit rating. The County's long term variable rate debt will not exceed 15% of the total outstanding general debt.

Investment of bond proceeds will be consistent with those authorized by existing State law and by the County's investment policy and applicable bond covenants. Bond proceeds shall be invested and tracked separately from other investments.

Debt Ratios

The County will use an objective, analytical approach to determine the amount of debt to be considered for authorization and issuance. This process involves the comparison of generally accepted debt ratios from comparable counties to the current County ratios. There ratios will be re-evaluated every five (5) years or sooner as market conditions dictate.

The County shall adhere to the following:

Net Direct Debt per Capita

This ratio measures the burden of direct debt placed on the population supporting the debt. This ratio is widely used by rating agencies as a measure of an issuer's ability to repay debt. The County's general obligation debt per capita will be in line with other North Carolina counties that maintain an Aaa bond rating. The County will maintain per capita debt that does not exceed $2,200.

Net Direct Debt as a Percentage of Assessed Valuation

This ratio measures debt levels against the property tax base that generates the tax revenues, which are the main source of debt repayment. The County will maintain its debt at no more that 1.60% of the countywide assessed value.

Net Direct Debt Service as Percentage of Operational Budget

This ratio reflects the County's budgetary flexibility to adapt spending levels and respond to economic condition changes. The County will maintain its net debt service at no more than 20% of the operational budget.

Ten year Payout Ratio

This ratio measures how quickly the County retires it outstanding indebtedness. A higher payout ratio preserves the County's capacity to borrow for future capital. The County will maintain not less than 66% for its ten-year payout.

Refinancing of Outstanding Debt

The County will continually review the County's outstanding debt and recommend issues for refunding as market opportunities arise. Debt shall be refinanced only for the purpose of achieving debt service savings, unless required to achieve specific debt management goals of the County. The estimation of net present savings should be, at a minimum, in the range of 6% of the refunded maturities before a refunding process would be considered unless the County otherwise determines the annual savings warrants the refunding. The County will not refinance debt for the purpose of deferring scheduled debt service, unless unique circumstances are present. The County is aware that refinancing for the purpose of deferring debt service may have an impact on its credit rating.

The County may issue advance refunding bonds when advantageous, legally permissible, and prudent and a net present value savings is achieved. Advance refunding transactions are those undertaken in advance of the first date the refunded debt can be called for optional redemption, and will require an establishment of an escrow account for the defeasance of the refunded debt. All costs incurred in completing the refunding shall be taken into account when determining the net present value savings.

The County may issue current refunding bonds when advantageous, legally permissible, and prudent and a net present value savings is achieved. Current refunding transactions shall be considered whenever possible. Current refunding transactions are those undertaken at or after the call date on outstanding debt, and provide for redemption and replacement of refunded debt within 90 days of issuance of the refunding debt.

Pay-As-You-Go Funding

The County shall use pay-as-you-go and other alternative sources of funding for capital projects to minimize debt levels. To have an effective pay-as-you-go program, at least one funding source must be identified that is consistent, reliable and large enough to provide for capital needs in an amount that reduces dependency on debt. In order to reduce the impact of capital programs on future years, the County will annually appropriate funds for its capital improvement plan. The County will also appropriate proceeds from all county land sales and other capital assets as deemed appropriate for capital projects. This practice will allow additional funding of capital improvement projects and reduce the County's dependence on borrowing. Pay-as-you –go funding will save money by eliminating interest expense on the funded projects and will improve financial flexibility in the event of sudden revenue shortfalls or emergency spending.

Issuance of Debt

The scheduling and amount of bond sales and installment purchase transaction will be recommended by the Finance Director and the County Manager. The Board of County Commissioners must approve the sale. These decisions will be based upon the identified cash flow requirements for each project to be financed, market conditions, and other relevant factors including debt ratios. If the cash requirements for capital projects are minimal in any given year, the County may choose not to issue debt but instead, the County may fund up-front project costs and reimburse these costs when financing is arranged. In these situations the County will adopt a reimbursement resolution prior to the expenditure of project funds.

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. Variable rate bonds, revenue and special obligation bonds and Installment Financings will be sold on a negotiated basis with a selected underwriter.

The County must receive an opinion acceptable to the market from a nationally recognized law firm that each financing transaction complies with applicable laws and all agreements in connection with any financing are legal, valid and binding obligations of the County.

Continuing Disclosure

In accordance with the Securities and Exchange Commission (SEC), Rule 15c-2-12, the County will provide financial and operating information to the repository or repositories designated by the SEC. Where applicable, the County will also provide its annual financial statements and other relevant information to rating agencies, corporate trustees, and as required by Continuing Disclosure requirements within all debt documents.

Arbitrage Liability Management

The County will maintain a system of record keeping and reporting to meet the arbitrage and rebate compliance requirements of the federal tax code. This effort includes tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the County's outstanding debt issues.

It is the County's policy to minimize the cost of arbitrage rebate and yield restriction while strictly complying with the applicable laws. Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, arbitrage calculation will be performed by qualified arbitrage professionals in strict adherence to applicable laws and regulations. These calculations will be done in accordance with required Internal Revenue Service reporting dates.

Financing Team

The County will provide for a solicitation and selection process for securing all professional services required in connection with any debt issues. The service professionals selected will be required to develop and implement the County's debt management policy with the goal of continuity, quality service and competitive prices.

Administration and Implementation

The County Manager and the Finance Director are responsible for the administration and issuance of debt including the completion of specific tasks and responsibilities included in this policy.