

## **The Role of the Local Government Commission\***

**5/2004**

### **History**

In 1931 the North Carolina General Assembly established the Local Government Commission to help address the problems in local government finance caused by the depression.

In 1933, 62 North Carolina counties, 152 cities and towns, and some 200 special districts were in default on the principal or the interest or both of outstanding obligations. Currently, the State of North Carolina has a larger number of AAA rated units than any other state, and the debt of its local governments in general finds a significantly better reception on the national bond markets than the national average. Many attribute this favored credit status, in part, to the work of the Local Government Commission.

### **Purpose**

The Local Government Commission or LGC, established by G.S. 159-3, renders assistance to local governments and public authorities in North Carolina. It is staffed by the Department of State Treasurer and approves the issuance of debt for all units of local government and assists those units with fiscal management.

The work of the LGC can be divided into three categories. First, a unit of government must receive LGC approval before it can borrow money. In reviewing each proposed borrowing, the LGC examines whether the amount being borrowed is an amount the unit can afford. Second, once borrowing is approved, the LGC is responsible for selling debt (or bonds) on the unit's behalf. While state agencies in a few other states are charged with approving local government debt; it is the combination of the power of approval with the power of sale that makes the LGC unique in the country. Third, the LGC staff regulates annual financial reporting by and annual auditing of local governments; generally monitor the fiscal health of local governments, and offer broad assistance in financial administration to local governments.

### **Make Up**

The Commission is composed of nine members: the State Treasurer, the Secretary of State, the State Auditor, the Secretary of Revenue, and five others by appointment (three by the Governor, one by the General Assembly upon the recommendation of the President Pro Tempore and one by the General Assembly upon the recommendation of the Speaker of the House). The State Treasurer serves as Chairman and selects the Secretary of the Commission, who heads the administrative staff serving the Commission.

The full LGC meets quarterly, with the four member executive committee meeting in the months when the full LGC does not meet. Special meetings also may occasionally be called.

## **Organization of the LGC**

The staff to the LGC is organized into two sections, debt management and fiscal management. The staff has traditionally preferred to operate as advisors to local officials rather than as a regulatory agency. Despite this fact, the LGC has a significant amount of regulatory authority, which comes from the Local Government Budget and Fiscal Control Act and the Local Government Bond Act. These laws provide the LGC with the ability to approve the issuance of almost all types of local government debt; sell some types of bonds; and oversee local government fiscal management, including the annual audit process, accounting systems, cash and investments and debt repayment.

Although all of these regulatory powers are essential, the most important is the power to take action in the event of an actual or likely default on debt service payments. The LGC is authorized to order a governing board to raise taxes or other revenues in adequate amounts to make debt service payments. If a governing board does not take these actions, then the LGC's orders carry the force of the governing board performing these actions itself.

## **Debt Management Section**

The Section issues and monitors all State debt, including debt secured by a pledge of the taxing power of the State and debt for which repayment is subject to appropriation. After voter approval of a bond issue and with the assistance of other State agencies, the Section determines the cash needs, plans for the repayment of debt (maturity schedules), and schedules bond sales at the most appropriate time. An official statement describing the bond issue and other required disclosures about the State is prepared with the advice and cooperation of bond counsel. Finally, the Section handles the actual sale and delivery of the bonds, maintains the State bond records and register of bonds, and monitors the debt service payments.

## **Debt Financing Steps**

G.S. 159-50 through -53, together with LGC regulation, lay out the formal steps for approval of general obligation bonds.

- 1) For public school bonds and community college bonds, the affected school board or the affected board of trustees adopts a resolution petitioning the county to issue bonds.
- 2) For all bonds (including schools bonds), the borrowing government's governing board adopts a resolution authorizing an application to the LGC to issue bonds.
- 3) The government's clerk publishes a notice of intention to apply to the LGC.

- 4) The government files its application with the LGC.
- 5) The LGC approves (or disapproves) the application.

In addition to the required formal steps, the LGC encourages units to seek the LGC's assistance and opinion on an issue before beginning the formal steps. This is called a preliminary conference and it recognized in G.S. 159-51. During a preliminary conference the LGC staff will undergo an active review of the proposed borrowing. Because staff cannot effectively review a project without a firm idea of the scope and cost, preliminary engineering studies should be completed before the LGC is contacted.

### **Bond Ratings**

When considering the purchase of a bond investors rely on bond ratings to determine the creditworthiness of the security. Three rating agencies rate local government bonds for the national market: Moody's Investors Service, Inc., Standard & Poor's Corporation, and Fitch Investors Service, Inc. Each rates bonds on an alphabetical scale, ranging from Aaa or AAA to Baa and BBB for securities generally considered to be of investment grade, to C or D for securities locked in default.

Rating Agencies and Rating Categories

Moody's	Standard & Poor	Fitch
Aaa	AAA	AAA
Aa	AA	AA
A	A	A
Baa	BBB	BBB
Ba	BB	BB
B	B	B
Caa	CC	CC
Ca	C	C
	D	D

The higher the rating obtained the lower the interest rate secured for borrowing. A "Triple A credit rating means that there is only a very remote possibility that a government will not make payments on its debt. Approximately 25% of the nation's "Triple A" rated local governments are found in North Carolina, more than any other state. North Carolina local governments also borrow money to pay for capital projects at interest rates that are routinely two-fifths to four-fifths of 1% below the interest rates incurred by equally rated local governments in other states.

### **Fiscal Management Section**

The Section's most important goals are to see that debt service and other payments are made in a timely manner and to ensure adequate financial reporting. A substantial amount of time is spent enhancing the quality of local government accounting systems and the annual audit process, improving the quality of reporting in local government financial statements, and providing better information to local government managers.

This section also provides training and technical assistance to local government independent auditors to improve audit quality. Another area to which a substantial amount of staff time is devoted is monitoring local government financial conditions for such items as low levels of available reserves, tax collection rates and statutory violations. The Section prepares statistical reports of General Fund fund balance available for appropriation, tax collections and investment earnings, water and sewer operations, electric system operations, school capital outlay spending and public hospital operations. The Section prepares a policies manual that covers topics such as budgeting, financial reporting, annual audit purchasing and payroll. The Section maintains five-year comparative financial data for all municipalities and counties. All of these reports and information is available on this web site.

### **Fund Balance Guidelines**

The staff of the LGC analyses the financial statements of cities and counties to determine the amount of fund balance available for appropriation in the General Fund, and the amount of fund balance available for appropriation as a percentage of prior year expenditures. These numbers are significant because the property tax is a major source of revenue in the General Fund. The majority of property tax revenues are received in the latter months of the calendar year. Therefore, there should be reserves on hand in the form of fund balance available for appropriation at June 30th to prevent the unit from experiencing cash flow difficulties during the first two quarters of the next fiscal year. The minimum level of fund balance available for appropriation that should be on hand to enable the unit to meet current obligations and to prevent the unit from experiencing cash flow difficulties is 8% of the prior year's expenditures. The levels of fund balance available for appropriate are summarized and reported annually in a memo prepared by the staff. The memo for the latest fiscal year for which data is available can be found at the following link: <http://www.treasurer.state.nc.us/NR/ronlyres/5EABFDC0-7DD0-48A4-9BB1-2292E0D8E2C9/0/MEMO1014R.pdf>

\*Information taken from State and Local Government Relations in North Carolina by Liner and Financing Capital Projects by Lawrence.