



## NORTH CAROLINA

OFFICE OF THE TREASURER

JANET COWELL, TREASURER

June 7, 2016

Members of the North Carolina General Assembly  
16 West Jones Street  
Raleigh, NC 27601

Dear Senators and Representatives:

I am writing you to express serious concerns about Senate Bill 554, "School Building Leasing Reform." This bill represents a major policy shift with statewide implications. As State Treasurer, it is my responsibility to ensure sound local and state government finances. As a member of the State Board of Education, I am committed to a quality education for every child. I recognize that there are real and pressing school infrastructure needs across North Carolina, especially in rural and economically-challenged areas and we need to look at innovative solutions. We must also do so in a manner consistent with our long history of conservative debt management.

The Department's Local Government Commission (LGC) oversees the sale and delivery of all state and local debt and monitors the repayment of that debt. The LGC is staffed by our State and Local Government Finance Division, which assists local governments in determining the feasibility of projects, the size of the financing and the most expedient form of financing. Additionally, the Division monitors and analyzes the fiscal and accounting practices of all local governments. The Division and the LGC have a long history, dating back to the Depression, of aiding distressed local governments with expertise and professionally-accepted accounting and debt management practices.

I asked the LGC staff to research Senate Bill 554 and to assess its implications. Senate Bill 554 is not a technical or local bill—it has major statewide implications for education and tax policy that warrant deeper scrutiny before such changes are considered. The bill is related to a \$1.4 billion Robeson County plan to finance and lease new schools that could be replicated statewide. The LGC was created to evaluate exactly these types of issues. However, this legislation has been drafted in such a manner that the LGC could be unable to disapprove this type of lease when it is presented to them. This makes the Department's opposition all the more important now before this bill can advance further.

Here are the concerns:

- Most consequentially, this legislation allows state student and teacher funding (the average daily membership) and all other state education funding to be used for school facilities, in this case to pay private developers. North Carolina has a long history of supporting state funding for teachers and education staff and county funding for school buildings. This bill would blur that division and could result in the layoff of school personnel to pay private companies.
- Allowing this financing could allow counties to take on more debt than they could afford, endangering their creditworthiness and limiting debt capacity to meet the eventual needs of its police, fire and rescue, or jails. In Robeson County, the debt burden per capita would rise from \$202 to \$4,694, a 2,224% increase and the highest in the state. Other counties could quickly follow in Robeson County's footsteps.
- This legislation would allow private developers to be paid before essential county services, even in times of emergencies or economic distress. It outlines that lease payments to private entities come before all other of the unit's obligations other than General Obligation debt.

- It would allow sales taxes to go to a private, for-profit company. Specifically, the bill would permit a local unit to refund a private for profit business entity for expenses incurred in operating the building from local sales or use taxes. Sales and use taxes are an important source of local government revenue. This bill assigns away these revenues to the private entity.
- The proposed language of the bill would exempt a governmental entity from submitting an operating lease to a competitive bid process. A competitive bid process is essential to transparency and obtaining the best available deal for constituents.
- The financial information could be entirely provided by the private developers, as is the case in Robeson County's proposal. No one should consider large spending plans financed over decades based upon unverified numbers. For debt financing, an independent, third-party analysis is not only prudent, but essential. Allowing those who aim to profit from these plans to design the financing model is a bad deal for taxpayers and a conflict of interest.

These are the conclusions based on researching the language of the bill by local government finance experts at the Department of State Treasurer. My staff has met with the bill sponsor and proponents of the legislation to discuss and potentially address these concerns. Unfortunately, these issues remain. As it is written, I strongly oppose and urge you to oppose Senate Bill 554 or its companion bill House Bill 1065.

Funding for education is our biggest fiscal issue and one that we should not take lightly. We have more needs than funding, but as we know from the Great Recession, risky financing methods and taking on more debt than you can afford can have disastrous consequences. The Local Government Commission is a model for other states and has helped North Carolina maintain some of the best-rated local government finances in the nation. The staff stands ready to help find innovative, sound ways to finance schools. These issues demand an honest, comprehensive discussion with the needs of our students coming first.

Sincerely yours,



Janet Cowell  
State Treasurer

CC: Governor Pat McCrory  
State Superintendent of Public Instruction June Atkinson  
Chairman Bill Cobey and members of the State Board of Education  
Auditor Beth Wood  
Members of the Local Government Commission

Attachment: Local Government Commission memo on Senate Bill 554 and Robeson County



JANET COWELL  
TREASURER

NORTH CAROLINA  
**DEPARTMENT OF STATE TREASURER**  
STATE AND LOCAL GOVERNMENT FINANCE DIVISION  
AND THE LOCAL GOVERNMENT COMMISSION

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GREGORY C. GASKINS  
DEPUTY TREASURER

**TO:** Local Government Commission  
**FROM:** Timothy Romocki, Director of Debt Management  
**SUBJECT:** Senate Bill 554 – School Building Leasing Reform  
**DATE:** May 25, 2016

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You may recall a proposal last year to make permanent the time-limited provisions related to capital leases of school buildings and facilities found in GS §115C-531 as well as design-build capital leases authorized by GS §115C-532. These provisions were added to Article 37 of Chapter 115C of the North Carolina General Statutes by Session Law 2006-232, and extended until July 1, 2015 by Session Law 2011-234. Last year, Senators Meredith, Curtis, Tillman, Lee and Smith-Ingram introduced Senate Bill 554 (SB 554) to eliminate the sunset and to allow certain sales tax refunds to be paid to private developers of these projects. Because a capital lease is a financing vehicle that is complicated and can create significant financial risk for counties and boards of education, the Department of State Treasurer opposed SB 554 and it was not acted on.

As you know, capital leases are financial arrangements where the lessor/developer brings little, if any, capital to the transaction. Instead, the developer raises capital by selling its rights to receive lease payments from the school system to a third party in exchange for an investment equal to the construction price. The investor's money is then used to pay for the construction, while treating the transaction as a tax exempt loan to a government entity. All amounts that are used to pay the third-party investor come from the lease payments made by the school system. Thus, the system is not just making lease payments; it is in effect financing the purchase of the asset through the lease. If the governmental entity does not make the lease payment, the failure to pay is treated in the capital markets as a default by the entity on its debt.

In early May of this year, discussions concerning SB 554 resurfaced. As we heard more about the bill, we learned about a specific financing being considered in Robeson County. We understand that the financing is supported by the Robeson County Board of Commissioners and that the school board in Robeson County has been divided on the issue due to its dependence on a controversial school consolidation plan.

We do not know all the details of the transaction, but have been allowed to review a proposed pre-development agreement (PDA) between the school board, the county, and entities associated with an architect/developer who promotes energy positive school construction in North and South Carolina. The energy positive school concept relies on

Memo to Local Government Commission  
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energy savings to fund some of the project's debt service. Additionally, the proposal presupposes other management and operating savings from a county-wide consolidation which requires closing 30 existing school buildings into 13 new leased buildings and five renovated ones.

On May 24, the Superintendent of Robeson County Schools invited representatives from our staff to speak at a special meeting of the Robeson County school board to advise the members of our concerns. The Department's legislative liaison, Tony Solari, and I spoke at the meeting acting in our roles as advisers on local government debt policy. Our goal in speaking to the school board was to help them understand the various risks associated with this kind of financing arrangement, and specifically, to share questions we had about elements of the PDA.

After our presentation and some discussion, the school board voted to table its discussion pending action by the legislature on SB 554. There may be additional inquiries of the Local Government Commission and the staff related to either SB 554 or the Robeson County school proposal. We will continue to monitor this situation and keep you informed.

The following is a list of general questions that we have raised to the members of the Robeson County school board and to various members of the General Assembly:

1. The numbers that we have seen in the financing model raise many questions. Each of these categories needs to be carefully reviewed. We question whether the savings identified can be sustained at the indicated levels plus inflation for the life of the 40 year lease obligation. If the savings aren't there, where will the extra money come from for the debt service/lease payments? This is a very large capital expenditure for Robeson County (approx. \$600 million), so what happens to its other needs? How will the transaction impact the County's credit? What type of rating will this capital financing get? What interest rate will be charged? We have not seen the final lease agreement, or all of the assumptions of the model, so there could be many additional questions.
2. The methodology for converting savings to funding is vague. Our analysts have reviewed similar projects and do not understand the structure. We have encouraged the school board to understand the proposal thoroughly before moving forward.
3. We have questions about the policy precedent of allowing a private party to receive a sales tax refund as a result of these school lease projects. The Commission staff has recent experience working with local governments who have suffered unintended negative consequences after connecting sale tax revenues with economic development. We have encouraged the school board to think carefully about the long-term effects of revenue arrangements and to understand the associated risks.

4. We encouraged the school board to fully understand the consultant costs required to complete this type of agreement. Since the costs of the proposed financing are higher than more traditional financings, we wanted to make sure that the board understood the fees and cash flows.
5. The PDA includes a pre-audit certificate obligating the school system for a \$7,000,000 payment. We noted that the obligation would need to be budgeted by either the county or the school board. In North Carolina, school systems do not have any independent means of raising construction funds and are dependent on the county for adequate appropriation.
6. We questioned whether the term “demonstrable financial savings” used in the PDA was sufficiently defined and specified since it is a key part of the termination clause.
7. We noted that government agreements often request information regarding the developer’s financial status and did not see that information in the current agreement. Furthermore, we observed that there is ambiguity connected to the real costs of the project.
8. The school board would not own the property but would be allowed to control it for academic and school activities. We noted that it is unclear who controls the non-academic uses of school property.
9. We noted that the PDA does not contain recourse for faulty work product. Further, we suggested that the school board verify the intent of the section of the PDA that includes provisions that would require a \$7 million termination payment by the school system even when the developer fails to perform and misses a target.
10. It was unclear from the PDA whether the parties intended the agreement to be exempt from the public records laws. We suggested that the school board study the issue and appropriately determine the applicability of public records statutes and/or exceptions.
11. We noted that the Robeson County Manager has stated that the transaction will likely cause a tax increase of approximately five cents per \$100 in value. We further shared that the transaction would also increase the per capita debt burden on Robeson County residents from \$202 to \$4,700, the highest of any county in the state.

cc: Greg Gaskins