Coates' Canons Blog: Local Government Commission (LGC) Approval of Contracts, Leases, and Other (Non-Debt) Financing Agreements

By Kara Millonzi

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Which of the following proposed transactions requires that the unit first seek approval from the State's Local Government Commission?

1. The Town of Blowing Rocks borrows $1 million from a local credit union to make repairs to several of its administrative buildings that were damaged in a recent storm. The town grants a security interest in the buildings to the credit union and agrees to repay the loan, with interest, over 59 months.

2. A developer borrows funds from a bank to construct a large office building in Trump Village's downtown. The village enters into a 20-year lease with the developer to use a large portion of the building to house its police department. The lease payments roughly correlate to the debt service paid by the developer on the borrowed funds. Trump Village is in no way obligated to guarantee or repay the developer's loan. The lease does not include an option to purchase or renew at the end of the lease term. The estimated total payments over the term of the lease are $4.9 million.

3. The City of Broke Springs owns and operates a water system. The city enters into an interlocal agreement with Flush County (the county in which the city is located), whereby the county agrees to loan the city $14.5 million to fund an expansion of the city's water lines into several unincorporated areas in the county. The city grants the county a security interest in the water lines and agrees to repay the loan, with interest, over a period of 15 years.

4. Shadow City's governing board establishes a non-profit (501(c)(3)) organization in order to qualify for certain private grants that the city is not eligible to receive. The city's governing board appoints the non-profit's board and approves the non-profit's budget each year. The non-profit uses the grant proceeds to jointly run a recreation program with the city targeted to at-risk youths in the city. The non-profit leverages a private building that was donated to it by a wealthy citizen by pledging the building as security for a $500,000 loan from a local bank to fund an outdoor adventure course, which will serve as the core infrastructure for the new recreation programs. The loan will be repaid by the non-profit over a 10-year period, with interest. The city's governing board approves the loan as part of its budget approval authority over the non-profit, but the city is in no way obligated to guarantee or repay the loan. The non-profit will donate the adventure course to the city as soon as the loan is repaid.

The answer is that **all** of the proposed transactions are subject to Local Government Commission approval. Established in 1931, the Local Government Commission or LGC is a nine-member body which provides assistance to local governments and public authorities in North Carolina. *See* **G.S. 159-3**. The LGC is responsible for monitoring and ensuring the fiscal health of local entities, and it approves (and sells) most local government debt.

The LGC's authority extends beyond approving debt issuances, though. The LGC also must approve several other types of contracts involving capital assets. The following summarizes the eight categories of transactions that (at least may) require LGC approval.

Group 1: LGC Approval Always Required

1. Unit issues General Obligation Bonds

2. Unit issues Revenue Bonds

3. Unit issues Special Obligation Bonds

4. Unit issues Project Developmetn Financing Bonds

Group 2: LGC Approval Sometimes Required

5. Unit enters into Installment Finance Agreement(s) (including issuing certificates of participation (COPs) or limited obligation bonds (LOBs))

6. Unit enters into Contract(s), Agreement(s), or MOU(s) involving the lease, acquisition, or construction of a capital asset

7. Another entity borrows money or enters into similar financing arrangement on behalf of the unit or on behalf of a public body, agency, or similar entity created by the unit

8. Unit enters into financing arrangement that is “similar” to borrowing money

The transactions listed in the first group always must be approved by the LGC, whereas those listed in the second group must be approved by the LGC only if certain additional criteria are satisfied.

It is crucial that a unit seek and obtain LGC approval of a transaction if such approval is statutorily required because otherwise the entire transaction is void. Thus, as a threshold issue, a unit should determine whether a proposed transaction fits into one of these eight categories and, if so, whether it is listed in the first group or the second group. If the transaction falls in the second group, the unit must then determine whether or not the additional criteria are satisfied. Click on these links for a series of flowcharts that navigate through the various additional criteria and exemptions for each of the eight categories: **Master Flowchart**; **Flowchart A; Flowchart B; Flowchart C; Flowchart D**.

The remainder of this post fleshes out the requirements and exemptions for the transactions in the second column.

5. Installment Finance Agreements

An installment finance agreement is a type of debt financing whereby a local unit finances or refinances the purchase, construction, or repair of a capital asset. The unit takes title to the capital asset and grants a security interest to the lender in all or a portion of the capital asset until the full amount due under the contract is paid. The authority for most installment finance agreements is **G.S. 160A-20**. This statute provides the legal authority both for simple installment financing contracts and for more complicated financing arrangements, such as when a unit issues certificates of participation (COPs) or limited obligation bonds (LOBs). (For more information on installment financing agreements, click **here**.)

The statute requires that installment financing agreements, COPs, and LOBs be approved by the LGC only if the transactions meet certain criteria set forth in **G.S. 160A-20(e)** and **G.S. 159-148(a)(1), (a)(2), and (a)(3)**, and only if the transactions are not exempted by **G.S. 159-148(b)(1), (b)(2), or (b)(3).**

Flowchart A provides an easy reference guide to the criteria and exemptions. Be sure to ask and answer the questions in the order in which they are presented in the flowchart.

Proposed transactions (1.) and (3.) above are examples of installment financing contracts. As you can verify by working your way through the flowchart, both transactions satisfy the additional criteria and are not exempted from LGC approval. Note particularly that, as illustrated by (3.), there is no exemption for transactions between local government entities. As discussed in a previous **post**, local governments are sometimes authorized to loan and borrow money from each other through interlocal agreements. Such agreements must follow all the same statutory provisions as if the funds were being borrowed from the private sector.

6. Contract(s), Agreement(s), or Memorandum of Understanding(s) Involving the Lease, Acquisition, or Construction of a Capital Asset

This category of transactions is the most overlooked by local governments. Anytime a unit enters into a lease of a capital asset (such as leasing equipment or leasing space in a building) or any other contract or agreement involving the acquisition or construction of a capital asset, it must first determine if LGC approval is required pursuant to **G.S. 159-148**. Specifically, the transaction must meet all the criteria set forth in **G.S. 159-148(a)(1), (a)(2), (a)(3), and (a)(4),** and the transaction must not be exempted by the provisions in **G.S. 159-148(b)(1), (b)(2), or (b)(3).**

Flowchart B provides an easy reference guide to the criteria and exemptions. Be sure to ask and answer the questions in the order in which they are presented in the flowchart.

Questions often arise about how to interpret **G.S. 159-148(a)(4)** (the fourth criterion in the flowchart). It requires that the lease, contract, agreement, or MOU "obligate[] the unit, expressly or by implication, to exercise its power to levy taxes either to make payments falling due under the contract, or to pay any judgment entered against the unit as a result of the unit's breach of the contract." This provision should be read in conjunction with **G.S. 159-13**, which requires a local government to appropriate monies each year to pay obligations arising under continuing contracts unless the governing board expressly reserves the right not to make the appropriations. The criterion will be satisfied unless (1) the unit's governing board reserves the right not to make any payments under the lease, contract, agreement, or MOU and the unit has no financial liability for breach; or (2) the unit's financial liability under the contract and for breach is limited to specific existing cash reserves or to specific non-tax revenue sources.

Proposed transaction (2.) is an example of a lease involving a capital asset that satisfies the criteria for LGC approval under **G.S. 159-148**.

7. Another Entity Borrows Money or Enters into Similar Financing Arrangement on behalf of the Unit or on behalf of a Public Body, Agency, or Similar Entity Created by the Unit

In 1998 the General Assembly made an additional category of transactions subject to LGC approval. It enacted **G.S. 159-153** which, among other things, requires LGC approval of certain transactions whereby a local government entity approves or otherwise participates in the incurrence of indebtedness (or a similar financing arrangement) by another entity on the local government entity's behalf.

A primary purpose of the statute was to require LGC approval of what are commonly referred to as 63-20 financings. Under this form of financing (which gets its name from IRS Revenue Ruling 63-20), a nonprofit corporation borrows money to construct a facility. If the corporation agrees to convey the facility, at no cost, to a government once the debt is repaid, and if that government formally approves the financing, then the interest on the debt may be exempt from federal income tax. Under the Internal Revenue Code, the debt is considered to have been incurred on behalf of the local government.

Even if the transaction does not constitute a 63-20 financing, if another entity borrows funds on behalf of a local government or on behalf of a public entity created by a local government **and** the local government approves or otherwise participates in the borrowing, the transaction may need to be approved by the LGC. There are certain additional criteria for LGC approval—namely the transaction must satisfy **G.S. 159-148(a)(1) and (a)(3),** and the transaction must not be exempted by **G.S. 159-148(b)(1), (b)(2), or (b)(3)**.

Flowchart C provides an easy reference guide to the criteria and exemptions. Be sure to ask and answer the questions in the order in which they are presented in the flowchart.

Proposed transaction (4.) is an example of a transaction that likely satisfies the criteria for LGC approval under **G.S. 159-153**.

8. Financing Arrangement that is "Similar" to Borrowing Money

When the General Assembly enacted **G.S. 159-153** it also included a catch-all provision to cover any future types of transactions that might be akin to a local unit borrowing money but might not technically fall into any of the other listed categories. Specifically, the statute requires LGC approval before a local government (or local government-created entity) "[e]nter[s] into any similar type of financing arrangement" to incurring indebtedness, if certain other criteria are met. The transaction must satisfy **G.S. 159-148(a)(1) and (a)(3),** and the transaction must not be exempted by **G.S. 159-148(b)(1), (b)(2), or (b)(3).**

Flowchart D provides an easy reference guide to the criteria and exemptions. Be sure to ask and answer the questions in the order in which they are presented in the flowchart.

Links

- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-3.html
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart1.docx
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_A.docx
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_B.docx
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_C.docx
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_D.docx
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-20.html
- canons.sog.unc.edu/?p=4695
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-148.html
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_A1.docx
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- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_B1.docx
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- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-153.html
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_C1.docx
- canons.sog.unc.edu/wp-content/uploads/2012/08/LGC_Approval_Flowchart_D1.docx