County of Durham

County Capital Improvement Program, Debt Affordability and Credit Standing

Presentation to the County Commission

April 1, 2019

DEC Associates, Inc.
Defining Emerging Concepts

Presentation Outline

- Introduction and Summary
- Review of Interest Rates and Forward Momentum
- Management of Debt and Financial Policy
- Capital Improvement Program and Debt Affordability
- Moody’s Rating Methodology and How the County Stacks Up
- How to Retain Our Financial Standing and Credit
- Closing

Summary

- Durham County economy is robust with continuing growth trend - downtown development and County-wide growth are especially noteworthy
- Interest rate markets are changing and trends have moved positively
- County finances compare well – future impacts similar to other growth areas
- CIP program well developed – current resource debt affordability into the future
- Balance of operating and capital is well understood at all levels
- Retaining strong financial standing depends on numerous factors –
  - The economy – not controlled by the County – County investments are important
  - Managing elements of financial standing controlled by the County
  - Continuation of current financial practices - important to maintain highest standing

Management and policy direction are ESSENTIAL!

Interest Rate Environments

Current Fixed Interest Rate Market Environment

Uncertainty is driving a flight to quality – benefitting tax-exempts

- Concerns over the economy and how long it can move upward
- Potential for recession and the depth and duration (recent Bond Market changes)
- Federal budget issues and future deficits

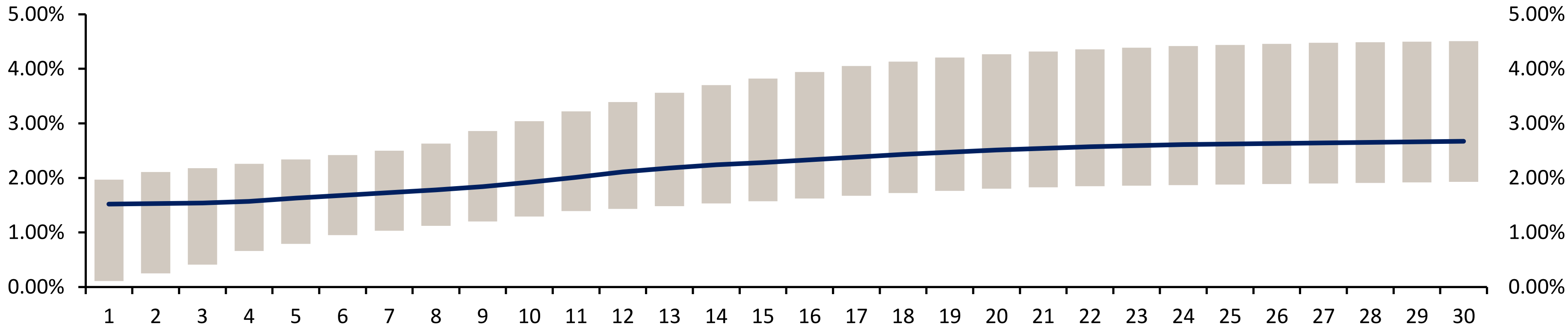
Interest rates have risen – especially at the short end of the curve

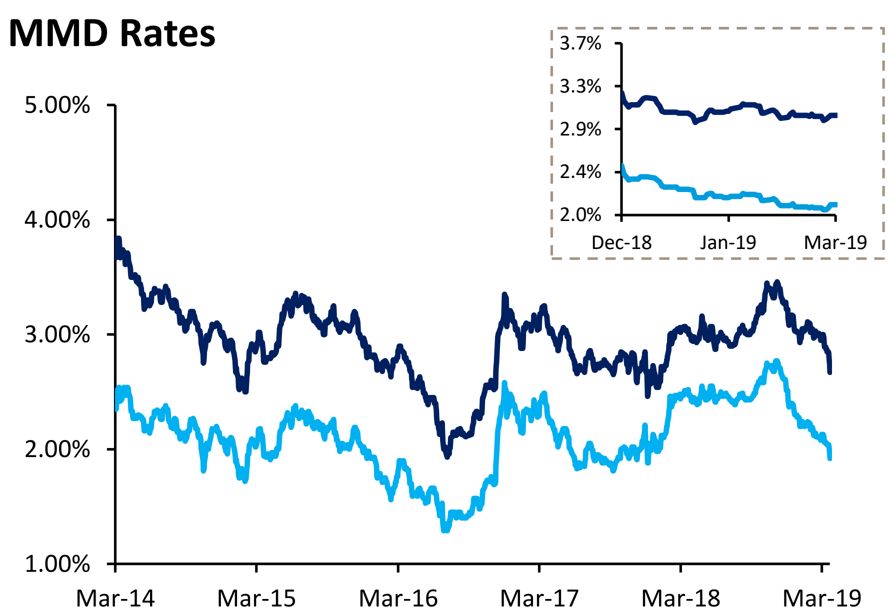
- Fed. raised short rates due to economic pick up (hopefully at maintenance level)
- Long-rates influenced by inflation (little present in the past, future inflation seems more stable, fears largely abated)

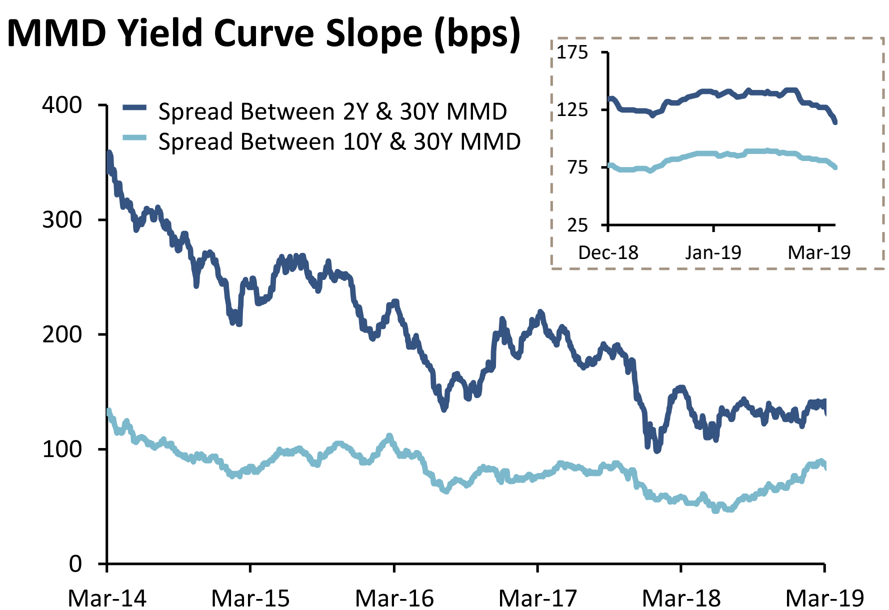
Tax-exempt interest rate movements should out perform taxable – correcting the spread imbalance

Current Fixed Rate Market Environment

AAA MMD Rates
Tax-Exempt Interest Rates: Five-Year History







Source: Thomson Reuters as of 3/22/19.

Debt Management
and
Overall Financial Policy

Managing Debt Policies, Issuance and Affordability

Debt policies are well developed and long-standing

- Drive how the County plans for and issues debt
- Policies provide flexibility in how the County borrows
- Policies provide roadmap to maintain highest credit ratings
- Debt issuance has been “spaced” for G.O. and LOBs based upon affordability

County debt planning model – used for many years (one of the first)

- Accomplishes several important planning objectives
- Dedicated revenues for debt service provide means to project future capacity
- Issuance of debt is projected based upon cash flow needs and procurement plans
- In conformance with the CIP
- Provides for new capacity beyond current CIP

Durham was leader in using “construction period” method of paying project costs

- Provides lower cost and proper issuance timing of higher cost fixed rate debt
- Provides forecasting future debt service benefits and lowers “negative” cost of carry

These debt management tools provide the ”real” test of debt affordability

Operating Financial Policies and Their Importance

Financial policies for operations of the County are important for many reasons

- Means to set management goals and craft a budget that meets service needs at acceptable cost
- Provide for sufficient cash flows to allow the operations of County programs from revenues that are collected throughout the year (fund balance policy)
- Others

Growth will create both positives and challenges to operating policies

- Balancing act of growing revenues being sufficient to meet operating cost growth (recent multiyear analysis)
- Levels of liquidity/fund balance needs will also increase making percent of budget fund balance policy evermore important

Maintaining sound operating financial policies are very important to highest ratings

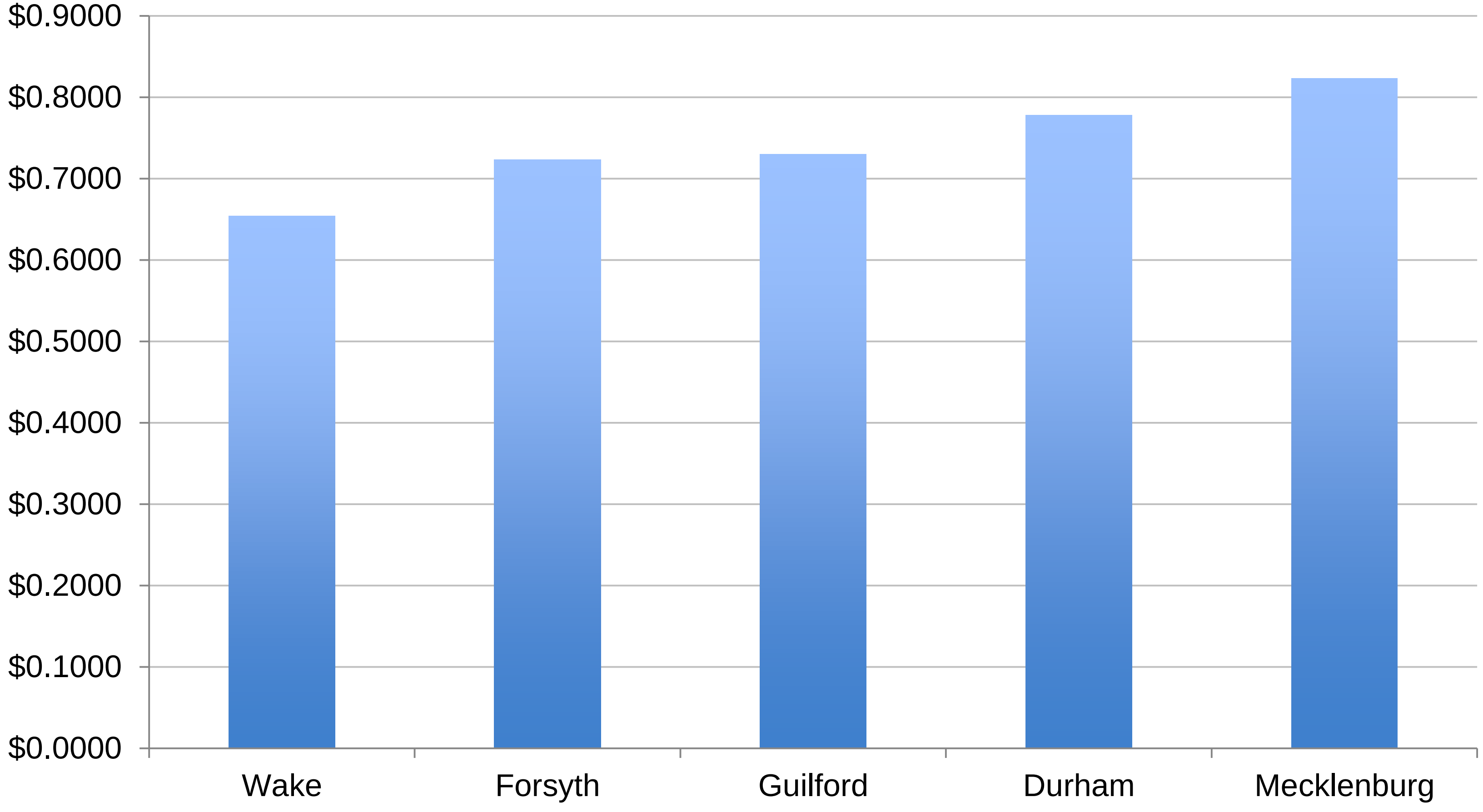
- Example, fund balance and cash levels – 30% of the Moody's rating
- Management – 20% of the rating

Durham is a model for sound operating policies

Current Property Tax Rates

Wake	Forsyth	Guilford	Durham	Mecklenburg
65.44¢	72.35¢	73.05¢	77.79¢	82.32¢

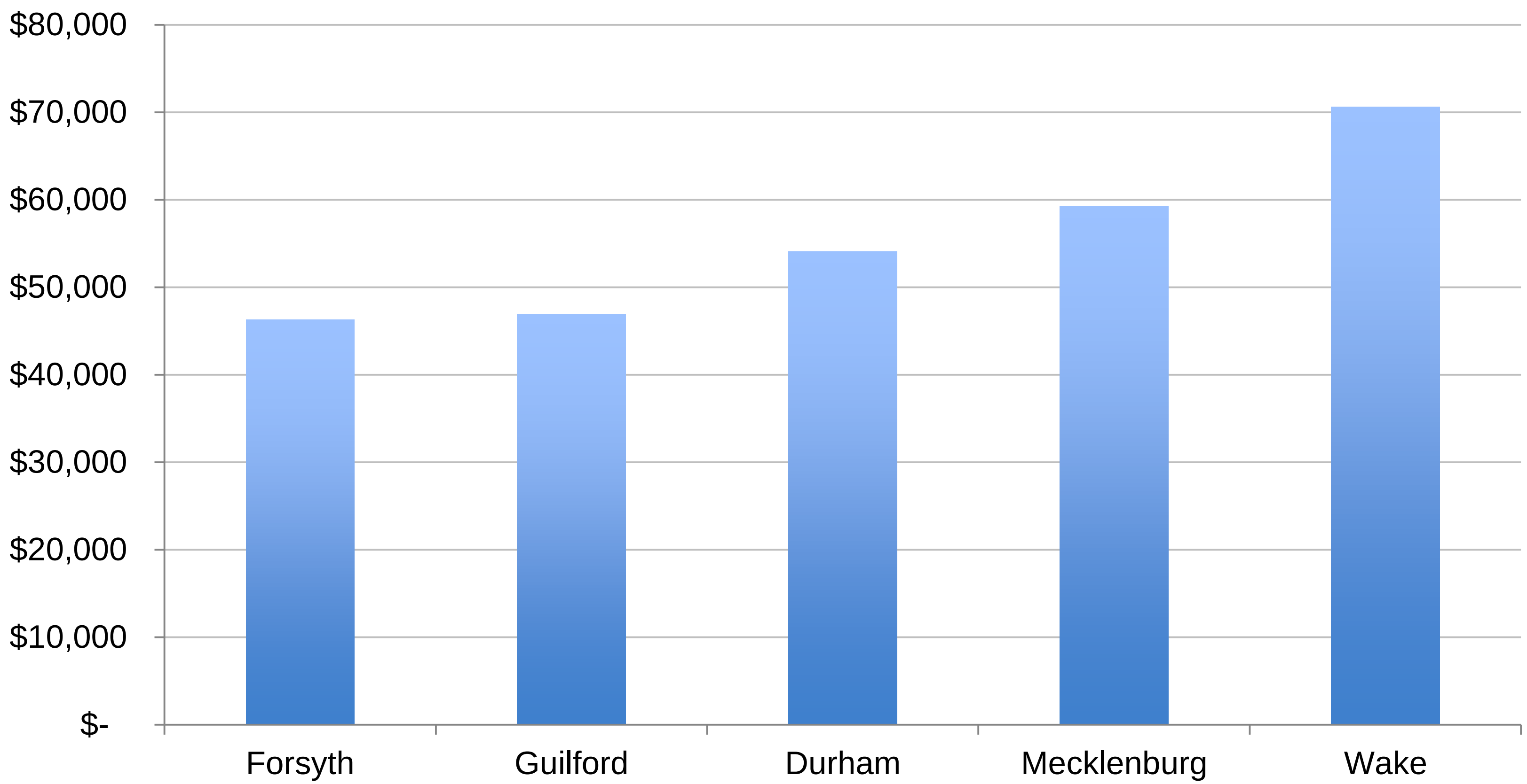
Source: NC DOR 2019 County Property Tax Rates and Revaluation Schedules



Current Median Family Income

Forsyth	Guilford	Durham	Mecklenburg	Wake
$62,424	$62,796	$75,254	$76,298	$91,701
88% of US Median	88% of US Median	106% of US Median	107% of US Median	129% of US Median

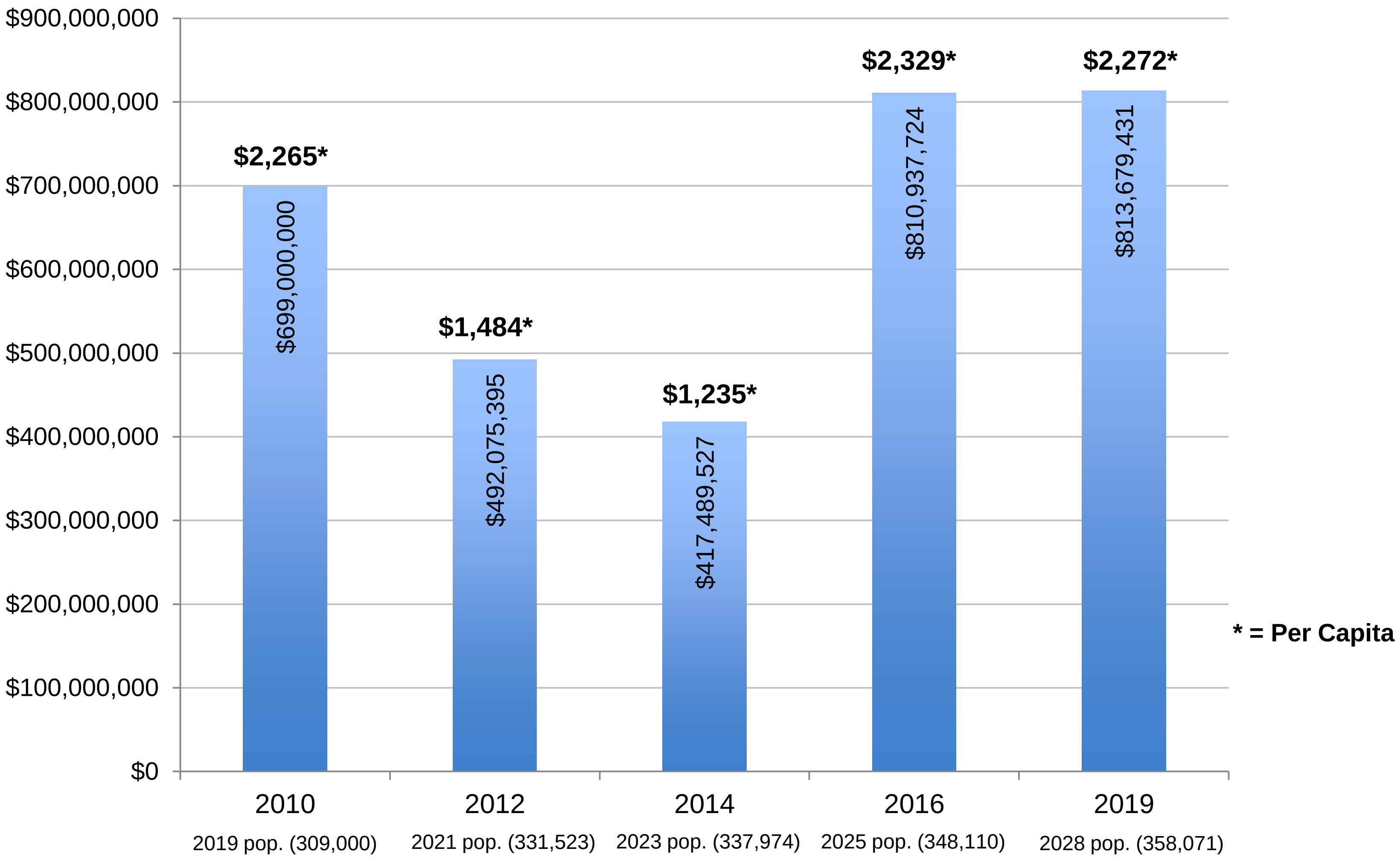
Source: 2017 Estimate from US Census Bureau



Capital Improvement Plan
and
Debt Affordability

Evolution Of The County Capital Program

The Following Graph Illustrates the Trend in 10 Year Capital Programs:



CIP Highlights and Program Initiatives

Program initiatives

- Continuing support for DPS
- Affordable housing support (part of public projects)
- Support for key EMS station additions (population growth and response needs)
- Development of Public Safety and Services Complex (in stages)
- Renovation of DSS Main Street building
- New Youth Home
- Others

Financial highlights

- Property tax support at 9.11 cents (1/2 cent increase)
- G.O. bond referendum moved from 2020 to 2022
- Prudent assumptions for revenue growth and cost of debt, etc.

Future flexibility

- Ability to maneuver project needs (accommodate reasonable levels of change)
- Continuing support of basic infrastructure needs
- Ability to adjust future debt issuance to meet future circumstances

Capital Improvement Plan Defines Need

Why would the CIP change

- Changes in economic conditions
- Growth in population/change in enrollment and patterns of attendance/other similar drivers
- Increasing cost in facilities especially for public schools
- Technology and other providers of efficiency in use of capital facilities
- Policy change
- Prioritization of capital need and inevitable timing changes
- Resources available to fund construction
- And more

Debt Issuance Defines Timing

Definition of specific project need/affordability occur at different time periods than those envisioned by the CIP

- In other words plans are just that
- Actual construction of capital projects occur after a process of more fully defining need and scope, together with cost and affordability and then on to design…..

Issuance of debt based upon cash flow needs of project expenditures

- Virtually assuring that financed projects timing will not match CIP view of timing
- Construction period financing has produced positives on debt service cost

Debt Issuance Defines Timing

What are the Impacts of the “mismatch” between the CIP process and when projects actually are financed

- Due to planning, design, procurement, etc, the actual time between announcing a project through the CIP and implementation are more wide than most of us would guess (common for large CIPs)

- For voted General Obligation Bonds the mismatch can create uncertainty with County residents (often assumed - vote means project is ready to start)

- Due to size of school needs, public input and use of G.O. financing the timing mismatch has been most prevalent

- Resulting in almost certain slower project timing (extend G.O.authorization)

Correcting Project Timing Mismatch

Solutions for timing mismatch

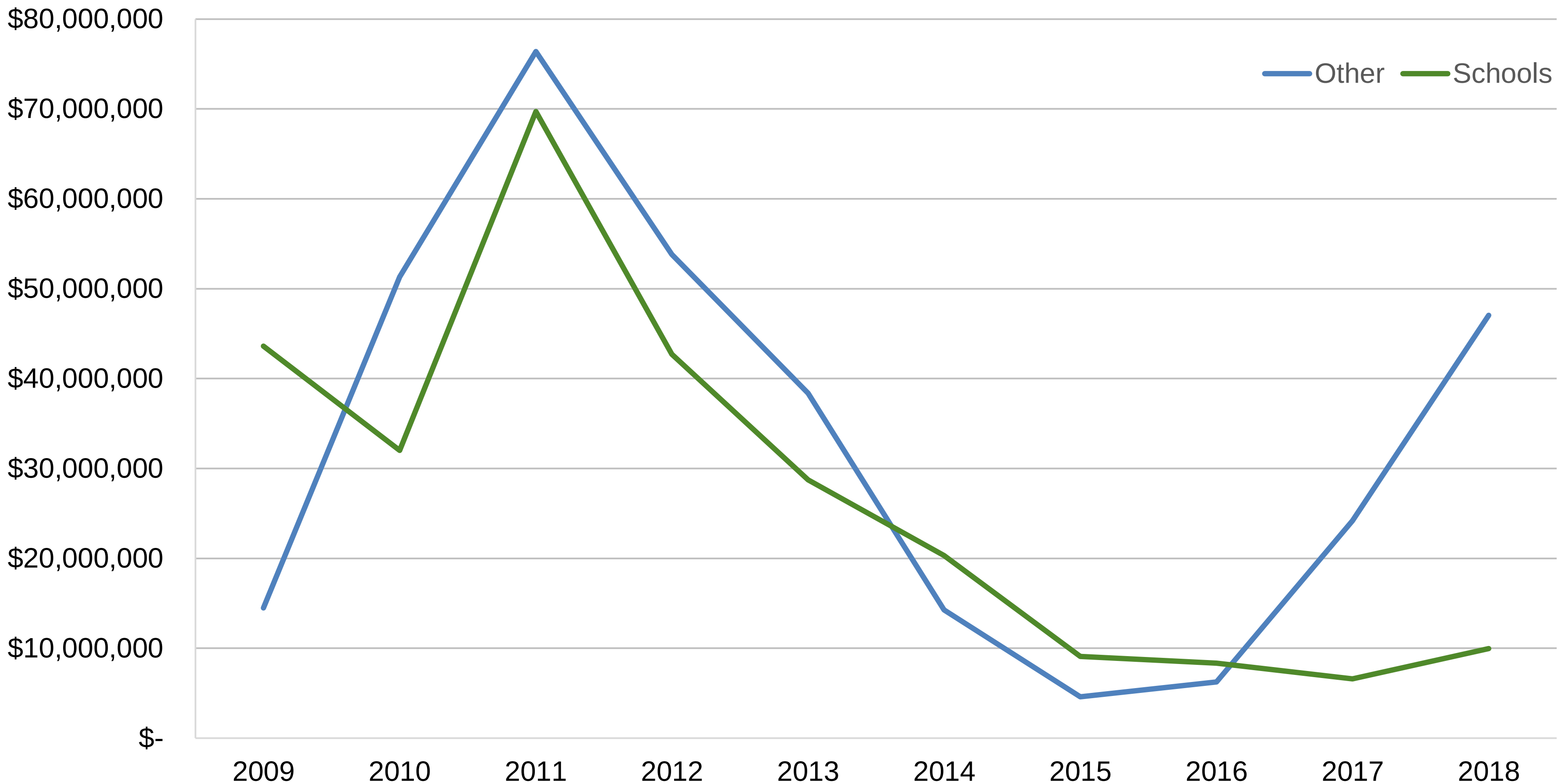
- More comprehensive project implementation, timing projections
- Scheduling bond votes to more closely match implementation timing (current CIP)
- More closely blend construction planning and coordination between County Schools and County staff and consultants
- Ongoing measurement of plans to actual timing and using the results to improve future project timing

Reduced mismatch will improve

- Citizen perceptions/understandings of when a project will be ready to use
- Debt affordability and planning for issuance

Attached history demonstrates actual expenditure of recent large projects

Debt Funded Capital Expenditure Ten Year History



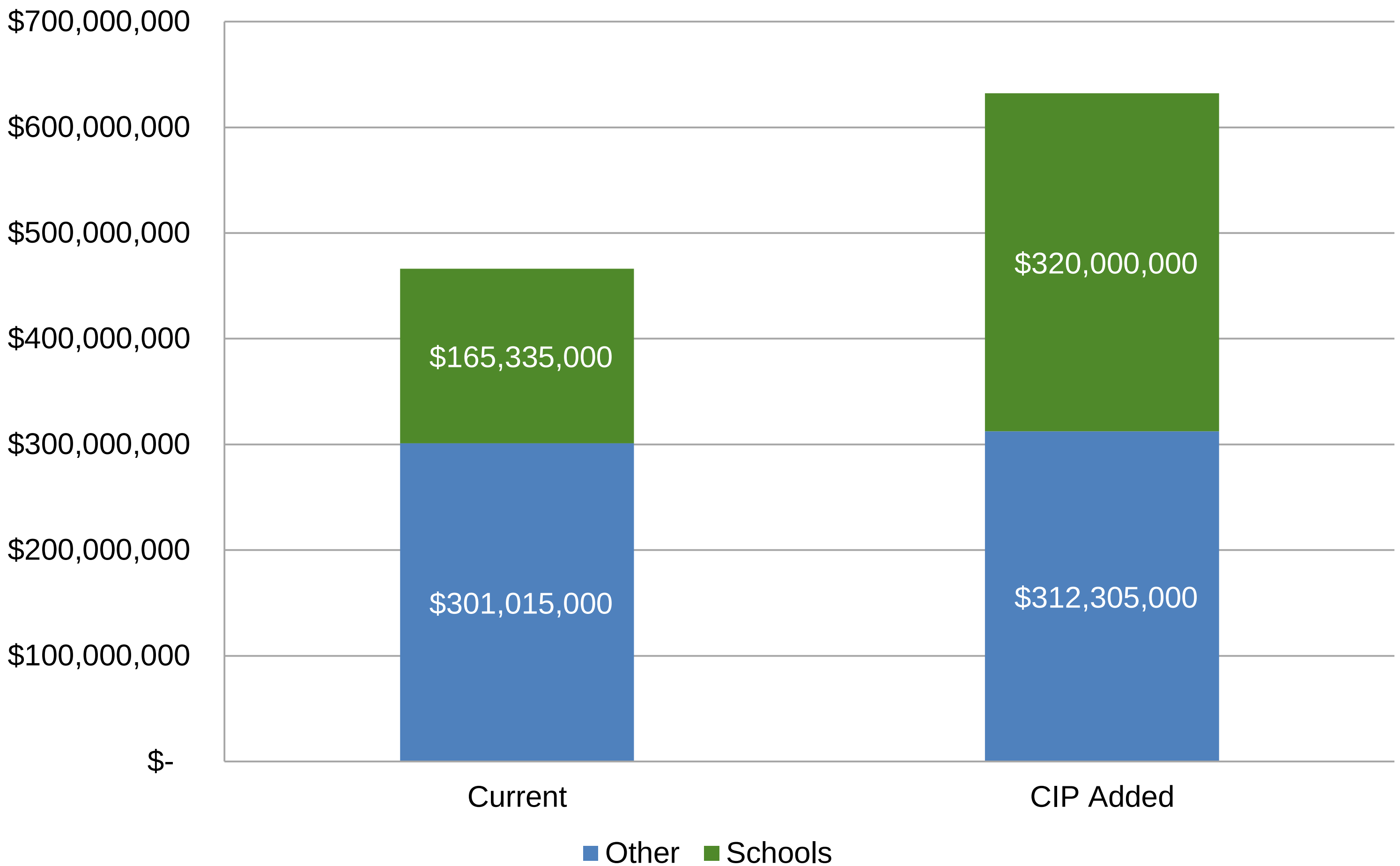
10 Year Totals	
Schools	$271,107,489
Other	$330,702,859
Total:	$601,810,348

GO Referendums	
2016	$170,000,000
2007	$207,100,000
2003	$123,665,000
2001	$74,660,000

Debt Affordability and the CIP

- Debt affordability is the measure of how much debt can be outstanding and be paid for by reasonable allocation of resources
  - Diversity and number of resources is important
  - Reasonable dedication of capital resources compared to operating is essential
  - Resources should be on-going and stable
- Durham has allocated for both debt and paygo
  - Multiple types of resources dedicated on on-going basis
  - Level of property tax, 9.11 cents, compares reasonably with others
  - Debt and paygo provided for at reasonable levels
- Current CIP model provides for debt affordability for the future
  - All anticipated debt can be paid for with resources dedicated
  - New debt/paygo can be accommodated by current affordability model

Long-Term Debt Outstanding and Planned



Moody’s Methodology and County Results

Moody's Methodology (January 2014)

General Obligation	Weight	Aaa	Aa	A
ECONOMY/TAX BASE	**30%**			
Tax Base Size (full value)	10%	> $12B	$12B ≥ n > $1.4B	$1.4B ≥ n > $240M
Full Value Per Capita	10%	> $150,000	$150,000 ≥ n > $65,000	$65,000 ≥ n > $35,000
Wealth (median family income)	10%	> 150% of US median	150% to 90% of US median	90% to 75% of US median
FINANCES	**30%**			
Fund Balance (% of revenues)	10%	> 30%	30% ≥ n > 15%	15% ≥ n > 5%
Fund Balance Trend (5-year change)	5%	> 25%	25% ≥ n > 10%	10% ≥ n > 0%
Cash Balance (% of revenues)	10%	> 25%	25% ≥ n > 10%	10% ≥ n > 5%
Cash Balance Trend (5-year change)	5%	> 25%	25% ≥ n > 10%	10% ≥ n > 0%

Moody’s Methodology (January 2014)

General Obligation	Weight	Aaa	Aa	A
MANAGEMENT	**20%**			
Institutional Framework	10%	Very strong legal ability to match resources with spending	Strong legal ability to match resources with spending	Moderate legal ability to match resources with spending
Operating History (5-year average of operating revenues / operating expenditures)	10%	> 1.05x	1.05x ≥ n > 1.02x	1.02x ≥ n > 0.98x
DEBT/PENSIONS	**20%**			
Debt to Full Value	5%	< 0.75%	0.75% ≤ n < 1.75%	1.75% ≤ n < 4.00%
Debt to Revenue	5%	< 0.33x	0.33x ≤ n < 0.67x	0.67x ≤ n < 3.00x
Moody's-adjusted Net Pension Liability (3-year average) to Full Value	5%	< 0.90%	0.90% ≤ n < 2.10%	2.10% ≤ n < 4.80%
Moody's-adjusted Net Pension Liability (3-year average) to Revenue	5%	< 0.40x	0.40x ≤ n < 0.80x	0.80x ≤ n < 3.60x

Selected Moody's Debt Ratios

	Durham	Forsyth	Guilford	Mecklenburg	Wake
Audit Year	2018	2018	2018	2018	2018
Net Direct Debt ($000)	472,816	524,765	725,580	1,459,373	2,186,509
Full Value ($000)	36,159,222	35,740,324	50,730,761	127,005,628	144,219,214
Operating Revenues ($000)	457,147	401,193	574,423	1,554,529	1,266,242
Net Direct Debt / Full Value	1.31%	1.47%	1.43%	1.15%	1.52%
Net Direct Debt / Operating Revenues	1.03x	1.31x	1.26x	0.94x	1.73x

Source: Moody's Internal Data

How to Retain Our Financial Standing and Credit

Stay the Course

Retain strong general credit metrics

- Resource dedication for both operations and capital
- Future budgets that continue to meet service needs at reasonable cost
- Constant monitoring of cost increases due to governmental “pass downs”
- Debt policies that provide for future debt affordability and timing
- Retention of sound fund balance and cash flow policies
- Others

Stay the Course

Maintain a CIP that meets needs

- Recognizing that prioritization is essential
- Retain dedicated resources for capital and debt service
- Manage to meet debt affordability
- Constantly monitor whether additional resources are needed for essential capital
- Maintain CIP/debt metrics to achieve triple A
- Others

Durham County Is a “Management” Triple A

“Management” Triple A is a term often used by DEC

- Growth and urbanism require making capital and operating investments at higher levels
  - Results in higher debt levels
  - Other credit metrics – not always in the highest category
- Urban environments can create credit metric mismatch
- For Durham County, an offset to credit metric mismatch is maintaining strong management and financial policies and annually achieving them

MANAGEMENT AT ALL LEVELS IS KEY TO HIGHEST CREDIT RATINGS!

Questions?