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Department of State Treasurer

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TO: Officials of State and Local Governments and Certified Public Accountants

FROM: Sharon Edmundson, Director, Fiscal Management

SUBJECT: 2007 Legislative Changes Affecting Local Governments

The 2007 Session of the North Carolina General Assembly brought a record number of bills introduced (over 3,600) and some material changes to the law for local governments. This memorandum reviews the significant changes, particularly as they relate to local government finance.

Medicaid Relief

Long-term Medicaid relief for counties was included in the 2007 budget as adopted by the General Assembly, adding to the one-year relief that was passed in 2006. The phased-in funding that corresponds with relinquishment of one-half cent of sales tax revenues will ultimately move responsibility for 100% of the non-federal Medicaid services to the State. Counties will still be responsible for the local administrative expenditures associated with Medicaid.

As adopted in the 2006 Session of the General Assembly, Medicaid relief began to affect counties in 2007. On October 1, 2007, the county Medicaid share was reduced by 25 percent, from 15 percent of the nonfederal share to 11.25 percent. Medicaid expenses incurred on or after October 1, 2007, are charged to counties at the lower percentage rate. Counties began to see their savings with the November Medicaid bill. To offset these additional costs to the State, counties have seen their Public School Building Capital Funds (ADM) reduced for the 2007-2008 fiscal year only. The calculation of the amount of Public School Building Capital Funds each county has given up was calculated one of two ways. In either calculation the net savings from Medicaid relief is calculated by deducting the loss of Public School Building Capital funds from the amount saved by the reduction in Medicaid costs.

If a county's savings from the reduced percentage share for 2007-2008 is *greater* than what it receives from the Public School Building Capital Fund (ADM), then the county allocation from the Public School Building Capital Fund (ADM) was reduced by 60 percent of that allocation for 2007-2008. If a county's Medicaid relief is *less* than its Public School Building Capital Fund allotment for 2007-2008, then the county's Public School Building Capital Fund (ADM) allotment was reduced by an amount equal to 60 percent of its Medicaid savings. Despite this single-year reduction in the Public School Building Capital Fund (ADM), total school capital funds were not reduced because counties have offset

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any lost Public School Building Capital funds by maintaining a level of capital spending that is equal to what the Public School Building Capital Fund receipts would have been without the Medicaid change.

The legislation also includes a hold harmless provision that guarantees each county will benefit by at least $500,000 as a result of Medicaid relief each year. Eligible counties received 90 percent of the estimated hold harmless payment with the March sales tax distribution, with a final payment made by August 15, 2008. The Medicaid hold harmless payment is based on actual figures in that actual Public School Building Capital receipts, actual Medicaid savings, and actual foregone sales taxes are used to calculate the hold harmless payments.

Effective July 1, 2008, the State will take over 50% of the counties' share of Medicaid expenses. Cities and counties will forgo one-quarter cent of the Article 44 sales tax (the per-capita portion) beginning 10/1/08 to offset the increased costs to the State. The $500,000 hold harmless provision discussed in the previous paragraph will continue, with payments made again with the March, 2009, sales tax distribution and a final payment in August of 2009. Counties will be required to hold municipalities harmless for the loss of their share of the Article 44 sales tax, including losses due to growth. These funds will come from the Article 39 sales tax and will be distributed to the municipalities directly from the Department of Revenue. Currently hold harmless payments made to the municipalities from the counties will not be included in the county hold harmless calculations. Legislation has been drafted to change this but it is unknown if it will be adopted in the upcoming session of the General Assembly.

Beginning on July 1, 2009, the county Medicaid share will be eliminated completely, with the State paying 100% of the non-federal Medicaid expenses. To offset these costs to the State, the remaining one-quarter cent of the Article 44 sales tax will be repealed and will be replaced with a comparable sales and use tax that will go to the State, beginning on October 1, 2009. The $500,000 hold harmless provision to counties will continue to hold, as will the hold harmless provision for municipalities. One further change will occur in that the distribution method for Article 42 sales tax will change from per capital to point of delivery, effective October 1, 2009. This change should increase sales tax revenues in the counties whose loss of revenue from the sales tax "swap" is expected to exceed the savings from Medicaid relief. The 60 percent restriction for school capital needs remains on Article 42 sales tax.

As a result of these series of changes to the sales tax structure, as of July 1, 2009, the local portion of total sales tax will be 2 cents, and the State rate will be 4.75 cents, assuming no further changes to the tax between now and 2009. Of the 2 cent local portion, 1.5 cents will be distributed on point of delivery while the remaining .5 cent being distributed on a per capita basis.

<u>New Revenue Options</u>

The General Assembly also gave counties the authority to levy a new one-quarter cent sales tax or a 0.4 percent land transfer tax, subject to voter approval. The use of either of these proceeds is not restricted by statute. There also is no statutory requirement that counties share these revenues, if adopted, with municipalities.

OPEB Investment Fund

Senate Bill 580, which was passed in the 2007 session, gives local governments the authority to set up irrevocable trusts with which to fund other post employment benefits (OPEB). The bill also allows the State Treasurer to offer an investment vehicle for local governments to invest their funds set aside for OPEB. This investment vehicle will give local governments the opportunity to invest in more long-term investments that are not currently available to them under G.S. 159-30. It will be set up as an irrevocable trust in a manner that meets the requirements for funding under GASB Statement No. 45. The law also gives local governments this opportunity for investing Law Enforcement Officers' Special Separation Allowance funds. Please see Memorandum No. 1085 for more information on these new investment options for local governments.

911 Funds and Charges

House Bill 1755 changes the system for charging and administering 911 funds. Effective January 1, 2008, the administration of 911 funds was consolidated under a single 911 Board. The charge for all 911 services, wireline and wireless, will be set at 70 cents or less should the 911 Board choose to do so. Charges will apply to all voice communication systems capable of accessing the 911 system, including voice over IP services. All proceeds from 911 charges are placed in a new State 911 Fund (Special Revenue Fund) from which monthly allocations will be made to primary public safety answering points (PSAPs). Funds distributed to local governments should be held in a Special Revenue Fund called the Emergency Telephone System Fund. These funds will be used for PSAP grants, and for reimbursement of commercial mobile radio service providers. The base amount of the distributions will be the 2006-2007 distribution amount plus a per capita amount, with the PSAPs held harmless at the 2006-2007 funding levels. Use of PSAP funds has been expanded to include in-state training of 911 personnel. Any wireline fund balance at December 31, 2007, should have been transferred to the unit's General Fund for use for any lawful purpose. 911 Funds are not State expenditures and are not subject to being reduced or withheld by the Governor. We are preparing a more in-depth memorandum on the changes in the 911 Fund and revenue source.

Motor Vehicle Registration Changes

House Bill 1688 changes the combined motor vehicle registration renewal and property tax collection system that is currently scheduled to go into effect in 2010. One change is that buyers will receive a limited registration plate that will expire on the last day of the second month following the date of application for the plate. The property tax on the vehicle will be due when the plate expires. This will eliminate the provision of the original legislation that had auto dealers collecting property taxes at the point of sale. The legislation also provides that the interest generated by the Combined Motor Vehicle and Registration Account in the Department of State Treasurer will be credited to that account for use by the State for the purposes for which the Account was created. Finally, any funds remaining in the Account after the integrated computer system for the combined assessment, billing, and collection of property taxes is complete and operations will be returned to the local governments on a pro rata basis determined by how much each government contributed to the Account.

Changes in Property Taxes

House Bill 1499 was ratified during the 2007 Session of the General Assembly and made some changes in the area of tax relief for some citizens. First, it increased the benefit of the property tax homestead exclusion by raising both the income eligibility limit and the amount excluded from taxation to $25,000. Second, it provides a property tax deferral to certain homeowners. If the owners meet the various requirements, the portion of property tax on the residence that exceeds 4% or 5% of the owners' income, depending on income levels, is deferred until the death of the taxpayer or until such time that the property ownership is transferred. If the property is transferred to a spouse who also qualifies for the deferral and that spouse occupies the property as a permanent resident, then the deferral continues until such time the spouse passes away or no longer qualifies for the deferral. There are a variety of qualifications that accompany these circumstances so please refer to the Statute for more details.

Flexible Payment, Law Enforcement Officers' Special Separation Allowance

House Bill 328 states that the LEOSSA is to be paid in equal installments on the payroll frequency used by the unit paying the benefit, rather than paying on the last day of the month.

Counties Allowed to Participate in Road Improvements; Changes to Powell Bill

Senate Bill 1513 (SL 2007-428), ratified on August 2, 2007, changes a long-standing law on road improvements. G.S. 136-51 and G.S. 136-98 now authorize but do not require counties to participate in the cost of rights-of-way, construction, reconstruction, improvement, or maintenance of roads in the State highway system under agreement with the Department of Transportation. The bill also modified G.S. 136-41.4 to allow municipalities to elect to reprogram their Powell Bill funds (all or a portion) to a Transportation Improvement Project currently on the approved project list within the municipality's limits. The minimum amount that may be reprogrammed is an amount equal to the amount needed to complete one full phase of the project selected or an amount that, when added to the amount already programmed for that project, would permit completion of at least one full phase of that project.

Water and Sewer Funding

The General Assembly funded a new grant program for water and sewer needs through the Rural Center, totaling $100 million. Please contact the Rural Center for more information on that program (http://www.ncruralcenter.org). The Clean Water Management Trust Fund also received full funding at $100 million for each fiscal year of the budget cycle.

Bid Thresholds Raised

House Bill 73 (SL 2007- 446) raised the formal bidding threshold to $500,000 from the previous threshold of $300,000 for construction or repair projects [G.S. 143-129(s)].

Local Government Surplus Property Donations

House Bill 1060 amends G.S. 160A-280 to allow a governmental unit to donate any surplus, obsolete, or unused personal property to another governmental unit. Personal property includes supplies, materials, and equipment. The governing board of the donating unit must post a public notice 5 days prior to adoption of the resolution that approves the donation. The resolution must be adopted prior to the donation.

Increase in Fidelity Bond Requirements for School Finance Officers

Effective July 1, 2008, the minimum bond required for school finance officers will be $50,000, with no maximum. The previous limits were a minimum of $10,000 with a maximum of $250,000. [G.S. 115C-441(a)].

Units Authorized to Enter into Installment Purchase Financing

House Bills 401 and 1132 authorize County Water and Sewer Districts and Public Health Authority Boards, respectively, to enter into installment purchase financing agreements to finance the purchase of real or personal property. House Bill 401 goes on to further authorize the County Water and Sewer Districts to finance the repair of fixtures or improvements on real property with installment financing. These bills amend G.S. 160A-20(h) and G.S. 130A-45.3(a).

Distribution of Scrap Tire Disposal Tax

Senate Bill 1472 (SL2007-153) amends G. S. 105-187.19 to change the distribution formula on the Scrap Tire Disposal Tax. This change will increase the distribution to counties. Each quarter, 8 percent (up from 5%) of the net proceeds will be credited to the Solid Waste Management Trust Fund; 22% (down from 27%) of the net proceeds will go to the Scrap Tire Disposal Account. The remaining 70% (up from 68%) will be distributed to counties on a per capital basis. The restrictions on the use of these funds remain intact.

Project Development Financing

Senate Bill 1196 (SL 2007-395) amends G. S. 159-103(a) to allow a city or a county to issue project development financing debt instruments and use the proceeds for one or more of the specified purposes for which either unit of government may issue general obligation bonds. The list of purposes includes items for which only counties may issue bonds and items for which only cities may issue bonds. This legislation allows either a city or county to issue project development financing instruments of any of the listed purposes.

In addition, the bill adds additional purposes for which project development financing debt instruments may be issued to include a wide variety of (1) parks and recreation facilities, (2) community college facilities and (3) public schools and related facilities.

The bill also amends G. S. 159-107(b) by deleting the requirement and process for adjusting the base valuation of a financing district when property is periodically revaluated.

Public Access to Public Employee Personnel Records

Senate Bill 1546 (SL 2007-508) changes the parameters of what is and is not available to the public with regards to public employee personnel records. This bill modified a number of General Statutes with regards to employees of various types of public entities as follows: 115C-230, local boards of education; 115D-28, community colleges; 122-C-158(b), mental health authorities and county mental health departments; 126-23, State agencies; 130A-45,9(b), public health authorities; 153A-98(b), county employees; 160A-168(b), municipal employees; and 162A-6.1(b) public authorities.

Each of the statutes referenced above is amended to require the indicated public entities to maintain records for any written contracts that exist between the entity and its employees, past or current, to the extent that the entity has that information. If the entity has written documents regarding an oral contract, those documents must be maintained as public records as well. The law currently requires each entity to maintain records for each employee on position, salary, date and amount of the most recent salary change, date of most recent promotion, demotion, transfer, suspension, separation, or other change in position classification, and the office or work station to which each employee is currently assigned. The law is now amended to define salary as “pay, benefits, incentives, bonuses, and deferred and all other forms of compensation paid by the employing entity” (SB 1546). These records, subject only to the rules and regulations for safekeeping of records adopted by each entity, are open for inspection, examination, and copying by any person during regular business hours.

G.S. 131E-257.2 is amended regarding the disclosure of personnel-related information for employees of public hospitals. The bill removed from public disclosure the current salary, and date and amount of the most recent increase or decrease in salary for employees of public hospitals. Different rules apply to covered officers of a public hospital and to the five key employees that are not covered officers, with the highest compensation. For the employees and officers, beginning with the fiscal year ending in 2008, the hospital must disclose each employee’s base salary, bonus compensation, plan-based incentive compensation, and the dollar value of all other compensation, including perks and other personal benefits. The law goes on to define covered officers, executive officer, and key employee.

We strongly urge units to consult with their attorneys to inform and educate staff on the finer points of this bill.

Conclusion

This memorandum covers the major elements of the cited legislation. There are many details in these bills with which units should familiarize themselves. We urge you to contact your attorney, your representative from the League of Municipalities or the Association of County Commissioners, or the Institute of Government for assistance in interpreting these or any other statutes. If you have any questions about any of the legislation noted in this memorandum, please call Sharon Edmundson at (919) 807-2380 or contact via email at sharon.edmundson@nctreasurer.com.