State of North Carolina
Department of State Treasurer

State and Local Government Finance Division
and the Local Government Commission

RICHARD H. MOORE
TREASURER

T. VANCE HOLLOMAN
DEPUTY TREASURER

Memorandum # 1058

TO: County and School Finance Officers and Their Auditors

FROM: T. Vance Holloman, Deputy Treasurer

DATE: April 28, 2006

SUBJECT: Impact of County Net Asset Deficits for School Debt upon Bond Ratings

Members of the Local Government Commission staff have recently discussed with the three major rating agencies the possible impact of negative net assets on the government-wide statements of some North Carolina counties prepared in accordance with GASB Statement No. 34. These negative net asset amounts have resulted from counties reporting debt issued for school construction and school boards reporting the assets. This results from the requirements of 115C-521 that require schools systems to construct and own schools assets and that counties provide funding for school capital needs.

All three rating agencies indicated that as long as school debt is the reason for the negative net assets and an explanation is disclosed in the Management's Discussion and Analysis and in the notes to the financial statements, the agencies would not down grade ratings now and do not anticipate doing so in the future. Staff members have also contacted three large underwriters of North Carolina local government debt. Those underwriters indicated that as long as ratings remained constant the negative net assets on the government-wide statements of counties would have no impact upon their bids for debt.

These recent responses from the rating agencies differed from responses members of our staff received at the time GASB Statement No. 34 was implemented. At that time the rating agencies' analysts indicated that they did not anticipate any immediate down grades because of the negative net asset amounts, but were not sure if downgrades might occur in the future. Since those initial comments were made, some counties and schools in the State have taken action to transfer ownership of school assets to the county to avoid possible down grades. Counties in North Carolina were joined in their concerns by local governments in similar situations in other states. In fact, the State of Virginia passed statutes granting their local governments an ownership interest in school buildings equal to their outstanding school debt in order to avoid reporting negative net assets. While there were grounds for these concerns based on earlier comments from rating agency analysts, under current rating agency policy, these steps do not appear to be necessary to protect bond ratings at this time.

We believe that it is not necessary to transfer ownership of school assets from the school boards to the counties to avoid down grades of bond ratings and higher financing costs at this time. We will continue to monitor the rating agencies views on this matter and keep, counties and school boards informed. Also, there may be other reasons for county ownership of school buildings such as an installment purchase financing of schools by a county or a county claiming a sales tax refund for school construction expenditures.

If you have any questions or comments on this memorandum, please contact Vance Holloman at (919) 807-2351.