Reasons for Fiscal Distress, and Strategies and Mechanisms for Relief

NCACC ANNUAL CONFERENCE
AUGUST 12, 2021
Sharon Edmundson, Deputy Treasurer
AGENDA

• Unit Assistance List – UAL
  • What it is and what it isn’t
  • How does a government get on it, and how does it come off
  • Consequences of being on the UAL
What is the Unit Assistance List?

• Started out (and remains) a working document to assist SLGFD staff in allocating limited resources to units that need the most help
  • Financial issues with General Fund
  • Financial issues with the significant utility fund(s)
  • Internal control weaknesses

• As late audits have become more of an issue, that element was added
  • Audits are due October 31st

• List is based on most currently available audited financial data
  • Rollover each spring to a new list based on previous FYE data
How is the UAL Developed?

• For most units (cities and counties in particular)
  • Look at fund balance available in General Fund
  • Look at liquidity measures, income, and cash flow in utility funds
  • Look at internal control findings
  • Consider any other facts known to SLGFD staff

• Cull the list until we believe we have identified units at risk
  • Of experiencing cash flow issues
  • Of potentially defaulting on debt
  • Of experiencing loss due to lack of sound internal controls
How is the UAL Developed?

• General Fund financial issues:
  • Low fund balance available
  • Pattern of declining fund balance available
  • Repeated used of fund balance available for operations
  • Repeated borrowing of money from other funds

• Utility Funds financial issues:
  • Liquidity ratio below 1.0
  • Negative cash flow from operations after debt service payments
  • Repeated used of fund balance available for operations
How is the UAL Developed?

• Internal control issues
  • Repeat material weaknesses or significant deficiencies of almost any kind
  • Findings related to recurring delays in bank reconciliations, subsidiary account reconciliations
  • Findings related to repeatedly over-spending the budget
  • Failure to have books ready for audit on time
  • Failure of management/Board to address vacancies in the finance officer position
  • Failure to hire qualified staff in key positions

• Other issues
  • Fraud
  • Loss of key personnel
More Facts About the UAL

• List is a public document, but we don’t publish it
• Have been notifying units by email for several years, added US Mail this year
• Update the list periodically throughout the annual cycle
  • Primarily to update for audits that have been submitted since previous update
• Units are notified in writing when they come off the list
UAL BY THE NUMBERS:
Based on June 30, 2020, audited data as of 4/23/2021

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<thead>
<tr>
<th></th>
<th>MUNIS</th>
<th>COUNTIES</th>
<th>UTILITY DIST</th>
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</thead>
<tbody>
<tr>
<td>NUMBER OF UNITS ON UAL</td>
<td>132</td>
<td>17</td>
<td>9</td>
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VARIOUS SUBSETS:

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<tr>
<td>Number for late audits</td>
<td>72</td>
<td>10</td>
<td>4</td>
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<tr>
<td>Number of units assessed</td>
<td>60</td>
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HIGH RISK:

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<tr>
<td>General Fund Financial</td>
<td>9</td>
<td>1</td>
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<td>Water/Sewer Financial</td>
<td>17</td>
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<td>2</td>
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<tr>
<td>Internal Control Weaknesses</td>
<td>14</td>
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<td>2</td>
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MODERATE RISK:

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<td>NA</td>
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<tr>
<td>Water/Sewer Financial</td>
<td>26</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Internal Control Weaknesses</td>
<td>27</td>
<td>1</td>
<td>2</td>
</tr>
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</table>
Top Ten Misconceptions about the UAL

10. Units on the UAL are all about to go bankrupt
9. The UAL consists only of smaller, more rural units
8. Everyone on the UAL is under investigation by SLGFD staff or by the State Auditor
7. The UAL never changes – once you are on, there’s no way out
6. Units on the UAL are being punished for something
5. Units on the UAL are about to be taken over by the LGC
4. Units on the UAL can’t borrow money
3. Units on the UAL can’t get approved for grants
2. Units on the UAL are about to have their charters revoked
1. No one cares about the UAL
Misconceptions

Units on UAL are about to be taken over by the LGC

**FALSE**

**TRUTH:** Units that the LGC exercises its authority with are on the UAL, but are a very small subset
Misconceptions

Units on the UAL can’t borrow money or be awarded grants

**TRUTH:** Units that are taking actionable steps to address their issues can move forward with loans and grants
Misconceptions

No one cares about the UAL

**TRUTH:** SLGFD staff works with units to move them off the list

General Assembly, advocacy groups raise questions and concerns about the units and number of units on the UAL
What **DOES** Happen When a Unit is on the UAL?

• Receive written communication from staff that unit is on the UAL and (broadly) why

• Follow-up from Fiscal Management staff based on priority – use a risk-based approach to prioritize work

• If come before LGC for debt approval, will need a solid action plan of attack to address issues
  • Verifiable details and data
  • Hope is not a strategy
  • In-depth understanding of findings in your audit
What **DOES** Happen When a Unit is on the UAL?

- New in 2021 – requested copies of draft 21-22 FY budget proposals
- Staff reviewed and provided feedback prior to budgets being adopted whenever possible
- Looked for
  - Appropriation of fund balance – repeated, over-appropriated
  - Use of appropriate tax collection percentage in budgeted current year tax
  - Made sure budget ordinance in proper form and funds balanced
- Plan to continue for 22-23 budget year
How Does a Unit Come Off the UAL?

• Address the issues that put the unit on the list
  • Late audit – devote enough resources to getting books in shape and audit done on time
  • General Fund financial concerns – cut expenditures/raise revenue to build fund balance
  • Utilities financial concerns – rate studies, willingness to increase rates, improve collections, reduce expenditures, seek professional guidance
  • Internal control concerns – address the underlying issues and the findings will take care of themselves
Addressing Utilities Fiscal Health

• A significant portion of municipalities on the UAL have issues with utilities

• Some systems face enormous challenges to make systems viable
  • Loss of customers
  • Aging infrastructure
  • Lack of professional management
  • Lack of understanding of issues by customers, elected officials, and others
QUESTIONS?

Contact Information

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Viable Utilities Program and Reserve

August 12, 2021

NC Association of County Commissioners Annual Conference

Viable Utilities Program and Reserve
Overview

- Overview & history
- Distressed Criteria
- Viable Utility Program requirements
- Viable Utility Reserve & other funding
- Next steps
The Stats for North Carolina

• ~10 million people
• Lots of utilities
  • ~500 drinking water utilities
  • ~300 publicly owned wastewater systems
• Lots of small systems
  • > 200 (40%) drinking water systems < 2,000 residential connections
  • Smallest 50% wastewater treatment plants serve ~4% of state’s population
History of North Carolina’s Rural Utilities

• Demographics
  • 1970 – > 50% of population in rural areas
  • 2010 – ~33% of population in rural areas

• Economics
  • Historically strong rural economies from industry and agriculture
  • Past 30 years moved away from rural areas

• Reoccurring natural disasters have made recovery especially difficult
Results of Challenges

- Reactive utility management
- Increased risk to public & environmental health
- Vulnerable to being distressed or non-viable systems

Many rural systems are in a state of quiet distress.
Viable Utility Program History

Charge to the State Water Infrastructure Authority (SWIA)

• Create a Master Plan
• Develop a troubled systems protocol
Viable Utility Program History

- Numerous committee meetings in the NC Legislature
- Signed into law by Governor Cooper on July 1, 2020 (S.S. 2020-79)
S.L. 2020-79 Highlights

• Provides definition for distressed local government units (LGUs)
• Requires designation of distressed LGUs
• Programmatic requirements for distressed LGUs
• Creates the Viable Utility Reserve (VUR)
S.L. 2020-79 Highlights

• Requires close working relationship between the LGC & State Water Infrastructure Authority (SWIA)

• Approvals
  • Distressed criteria
  • Education component
  • Priority Rating System for study grants
  • Funding from the Viable Utility Reserve

• Accomplishments so far
  • Approved distressed criteria
  • Designated distressed LGUs & reassessment frequencies
  • Approved educational component & Priority Rating System for study grants
“Distressed unit. – A public water system or wastewater system operated by a local government unit exhibiting signs of failure to identify or address those financial or operating needs necessary to enable that system to become or to remain a local government unit generating sufficient revenues to adequately fund management and operations, personnel, appropriate levels of maintenance, and reinvestment that facilitate the provision of reliable water or wastewater services.”
Distressed Criteria

• Identification Criteria
  • #1 – LGC fiscal control of LGU
  • #2 – Missing audits
  • #3 – Assessment Criteria score
  • #4 – Other information

• Assessment Criteria
  • Required by statute
  • Infrastructure
  • Organizational
  • Financial

• Assessment Criteria potential designation
  • Water & sewer LGUs ≥ 9
  • Single-service LGUs ≥ 8
Distressed Designation Brief History

• Distressed criteria approved by LGC & SWIA in November 2020

• Draft list of LGUs approved in December 2020

• Final list of distressed LGUs approved
  • LGC ⇒ February 2021
  • SWIA ⇒ April 2021
  • 18 LGUs “On-hold” pending additional review in 2022

• Distressed LGU reassessment cycles put into place (in process)
Viable Utility Programmatic Requirements – Initial Education

• Required by statute
• Approved by LGC & SWIA in July 2021
• Who must attend
  • Elected officials
  • Utility staff
• Two methods of delivery
  • In-person training
  • Online on-demand via NCLM
Viable Utility Programmatic Requirements – Initial Education

• Purpose – To provide trainees with the tools to take “first steps” they can implement within weeks of completing the training

• Four modules
  • Utility management basics
  • Infrastructure best practices
  • Organizational best practices
  • Financial best practices
If your unit has been designated distressed, required process is established by legislation

- Conduct an **asset assessment** and **rate study**
- Participate in a **training and education** program
- Develop an **action plan**, taking into consideration the following:
  - A **short-term** and a **long-term** plan for infrastructure repair, maintenance, and management;
  - **Continuing education**; and
  - Long-term **financial management** to ensure sufficient revenue to fund: Management and operations, Personnel, and Maintenance.
Viable Utility Program – VUR Fund

• Viable Utility Reserve (VUR) fund
  ▪ Currently ~$5 million in fund
  ▪ Expect significant increase in 2021 budget/ARP

• May be used for
  ▪ Emergency operating grants (LGUs under LGC control)
  ▪ Studies: AIA, MRF, Rate Study
  ▪ Capital projects

• SWIA and LGC approve amounts and terms
• Grants may include specific performance measures
Viable Utility Program – Funding

• Viable Utility Reserve (VUR) Study Grant applications available for Fall 2021!

• Eligible recipients:
  • Designated “Distressed” local government units (LGUs)
  • Non-Designated partners of Distressed LGUs
  • Allows Councils of Government (COGs) to apply

• Fall 2021 round: **Study Grants** only
  • Asset Inventory and Assessment (AIA)
  • Merger and Regionalization Feasibility (MRF)
  • Rate Study

• Future rounds: Project (Infrastructure) Grants
Viable Utility Program – Role of Counties

• 96 designated LGUs in 45 Counties
• Regional partnerships encouraged
• LGU engagement, commitment, and accountability
Viable Utility Program – Role of Counties

• Partner in Merger and Regionalization Feasibility (MRF) Studies
  • Does NOT need to include physical interconnection
  • Expect regional cooperation (e.g., resource sharing)
  • Robust comparison of ALL reasonable alternatives
  • Actionable efforts and projects to address designation
  • Integrate with AIAs and Rate Studies
  • Must identify MRF study lead
  • Requires governing body resolutions
Viable Utility Program – What’s Next?

• Award Study Grant funding (applications due Sept. 30)
• Work closely with designated LGUs and partnerships
• Hire two additional staff
• Roll out education program
• Continue working on program guidance and protocols
• Collaborate with resource agency partners
• Prepare for Spring 2021 funding round

Future

• Promote ongoing utility best management practices
• Develop models for sustainable water and wastewater management
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Program Objectives

• Assist neediest units

• Local government engagement, commitment, and accountability

• Actionable efforts and projects to transition distressed unit into viable unit
  ▪ MRF funding requests should address reasons for distressed designation

• Integrated MRF, AIA, and Rate Studies
  ▪ Cost and communication efficiency
  ▪ Leverage the results of previous studies
Prioritization based on:

1. Designation criterion
   - D1 = Unit under control of LGC = **Highest Priority**
   - D2-D4 = Other designated units (typically based on assessment score)

2. Assessment score
   - >13 = **Highest Priority**
   - 11-12
   - 8-10
   - If funding is limited and not all LGUs in the subgroup can be funded, priority would be further prioritized:
     - Revenue Outlook: 15 points
     - Moratorium: 15 points
     - Service Population <1,000: 10 points
     - Ability to address multiple distressed units: 5 points
Viable Utility Program – Distressed Criteria

- Distressed criteria created to identify LGUs that could use assistance finding solutions that will help them to be financially sound and viable.

- Four approved criteria
  1. LGC has taken fiscal control of LGU (D1)
  2. No annual audit submitted in the past 2 years (D2)
  3. Total Assessment Criteria score (D3)
     - 20 separate parameters with values ranging from 1-4 points
     - Threshold of 9 pts for LGUs with both water & wastewater systems
     - Threshold of 8 pts for LGUs with only one service (DW or WW)
  4. Other available information (D4)