North Carolina Department of Transportation
Debt Management

NCDOT Policy
D.01.0105

Business Category: Financial Management		**Business Area:** Finance
Approval Date: 1/19/2021	**Last Revision Date:** 8/1/2022	**Next Review Date:** 6/30/2023
Authority: N. C. Gen. Stat. General Statute §136-18 (12b) GARVEE N.C. Gen. Stat. §142 Article 9. State Capital Facilities Finance Act N.C. Gen. Stat. §147 Article 6A Cash Management N.C. Gen. Stat. §143C, Article 6, Part 2 Highway Appropriations Session Law 2020-91, House Bill 77 Session Law 2021-189, House Bill 334, Section 7.1		**Select all that apply:** ☒ N/A ☐ Requires Board approval Click to type Board name. ☐ Requires Federal Highways Administration (FHWA) approval ☐ Requires other external agency approval: Click here to enter external agency name(s).

Definitions:

"BOT" – shall mean Board of Transportation.

"CFO" – shall mean the Chief Financial Officer of the North Carolina Department of Transportation.

"FHWA" – shall mean Federal Highway Administration.

"HF" – shall mean the Highway Fund.

"HTF" – shall mean the Highway Trust Fund.

"NCDOT" – shall mean the North Carolina Department of Transportation.

"NCTA" – shall mean North Carolina Turnpike Authority.

"OSBM" – shall mean Office of State Budget & Management.

"SLGFD" – shall mean State and Local Government Finance Division of State Treasurer.

"STIP"' – shall mean A 10-year State and Federal-mandated plan that identifies the construction funding for and scheduling of transportation projects throughout the state.

Policy:

I. Introduction

A. Purpose

North Carolina Department of Transportation (NCDOT) has established guidelines and a framework for the issuance and management of NCDOT's debt. NCDOT is committed to consistent, best practices financial management, including maintaining the financial strength and flexibility of NCDOT and the full and timely repayment of all financial obligations. Debt transactions that violate any terms of existing financing documents, in particular Trust Agreements, or state and federal laws will not be considered. NCDOT is open to recommendations or ideas for any proposed transaction as well as variations from the following guidelines provided that such variation must be fully examined in conjunction with the Office of State Treasurer, Office of State Budget and Management, Federal Highway Administration (FHWA), and NCDOT leadership to include the Board of Transportation.

NCDOT currently utilizes two primary bond types: Build NC Bonds and GARVEE Bonds. This Policy is oriented toward these two bond programs. This Policy does not address or govern NCDOT's engagement in Public-Private-Partnerships, North Carolina Turnpike Authority's (NCTA) bond programs, Port Authority or Global TransPark. However, NCDOT does provide Highway Trust Fund dollars for NCTA debt service each year which impacts debt capacity for the agency.

B. Review

This Policy as well as related debt capacity and debt affordability matters will be reviewed by NCDOT annually. This Policy will also be made available on the NCDOT's website (https://www.ncdot.gov/).

C. Best Interest of NCDOT

Although adherence to this policy is desirable, deviations from the policy may be appropriate at times to address: (i) changing financial goals; (ii) emerging financial products/debt structures; and/or (iii) unique market opportunities. Consequently, the best interests of NCDOT will supersede any provision of the policy.

II. Financial Planning and Debt Issuance Policy

A. NCDOT will utilize the most recent revenue estimates for the Highway Fund (HF) and Highway Trust Fund (HTF), which are updated at least annually, for all projects and consistent with the STIP.

B. NCDOT will develop, maintain, and update, as appropriate, comprehensive Financial Planning Models as tools in developing a financing plan for existing and proposed projects including tolling. NCDOT will annually review its capital plans and adjust them as necessary to comply with the annual debt coverage commitments.

C. Financial Planning Models will incorporate longer-term capital improvements and the following elements in addition to other factors:

1. Revenue projections
2. Existing debt service requirements
3. Capital project costs
4. Projected Operations and Maintenance expenses and Renewal and Replacement expenses along with required deposits to all reserves
5. Estimated additional debt service requirements
6. Estimated investment income

D. Long-term debt will be used to finance capital projects where it is cost effective, prudent, or otherwise determined to be in the best interest of NCDOT. Long-term debt, which includes capital lease financings, will not be used to fund NCDOT's non-capital operating costs. The maturity of long-term debt issued by NCDOT to finance an asset or project should not exceed the half-life of the asset or project financed.

E. Medium-term or "put bond shifts" will be used judiciously and only after careful analysis and discussion of the interest rate and rollover risks involved.

F. Variable rate debt may be issued in various forms - e.g., bonds, commercial paper, bank lines. The amount of unhedged variable rate debt generally should not exceed 15% of outstanding debt for any NCDOT bond lien. As a goal, NCDOT desires its total hedged and unhedged variable rate debt not to exceed 25% of outstanding long-term debt for any NCDOT bond lien. Variable rate debt may be considered for the purposes of:

1. Lower interest rate costs
2. Asset/Liability matching
3. Cash management

G. NCDOT may retain the services of a registered Municipal Advisor to serve in capacity as Financial Advisor to perform the tasks set forth in this policy.

III. Debt Service Coverage Targets and Limits

The amount of bonds to be issued is limited by both authorizing statute as well as the respective bond lien Trust Agreements that govern the debt issuance and covenants contained therein, including, but not limited to, the additional bonds test. Target debt service coverage levels, leverage ratios and liquidity metrics will be set based on the most recent debt affordability parameters as well as rating agency guidance to ensure appropriately high credit ratings are attained on all NCDOT HTF and HF backed debt. NCDOT has different sets of constraints for the Build NC Bonds and GARVEE Bonds.

GARVEE bonds by statute are governed by one of the two constraints: 1. the outstanding principal does not exceed the authorized federal funds in the immediately prior Federal Fiscal Year; 2. the maximum annual principal and interest does not exceed 20% of the expected average annual federal revenue shown for the seven-year period in the most recently adopted STIP. The 20% debt service limitation is equivalent to 5.0 times coverage of Federal-aid revenue over debt service. The GARVEE bonds trust agreement also includes a 3.0 times additional bonds test ratio of Federal-aid revenue over debt service.

Pursuant to the 2020 Debt Affordability Study prepared by the Debt Affordability Advisory Committee, the Build NC debt service, together with similar debt-like commitments such as debt service on NCTA's state appropriation revenue bonds, is not to exceed 6% of combined HTF and HF revenues. This debt affordability metric is equivalent to 16.67 times coverage of HTF & HF revenues over Build NC debt service and similar debt like payments, which is a very conservative metric. Build NC Bonds by statute are limited to $3 billion in aggregate issuances and to $300 million in each fiscal year, subject to appropriation by the General Assembly and requires repayment of debt from the Highway Trust Fund. In addition, the State Treasurer shall not issue any Build NC Bonds unless:

1. The State Treasurer recommends the issuance of the Build NC Bonds and
2. The State Treasurer has decided that all statutory requirements are met.

NCDOT must have an average month-end cash balance for the first three months in the calendar year prior to the date of determination equal to or less than $1 billion, except for the 2021-2023 fiscal biennium, where the cash balance must be equal to or less than $2 billion, provided, however, that for any issuance of Build NC Bonds on or before June 30, 2022, the cash balance requirement for the biennium shall not apply.

Per this Policy, NCDOT will manage Build NC Bonds debt service and similar debt like commitments paid from the HTF such that HTF revenues (not including HF) cover debt service & commitments by 4.0 times.

IV. Debt Structure

A. NCDOT will engage the State and Local Government Finance Division (SLGFD) at the appropriate time for approval and guidance on proposed debt issuances and will partner with SLGFD staff throughout the debt issuance process. NCDOT will follow SLGFD guidelines for requesting approval including organizing transaction updates to SLGFD staff, providing transaction overviews and materials to the Commission, and requesting approval in a timely manner.

B. NCDOT will seek approval from the BOT prior to debt issuance.

C. NCDOT may utilize various debt structures to accomplish its financing goals, including but not limited to, the use of premium bonds, discount bonds, capital appreciation bonds, convertible capital appreciation bonds, bond anticipation notes, commercial paper, variable rate and multimodal bonds, and capitalized interest, when appropriate to achieve the goals provided in this Debt Management Policy.

D. NCDOT will consider interest rate swap transactions only as they relate to its debt management program and not as an investment instrument. No swap transaction should impair the outstanding bond rating of NCDOT's rated obligations. If swaps or similar hedges are considered, appropriate policies and credit standards will be incorporated into this Policy.

V. Coupon Structure and Call Provisions

With the goal of obtaining the optimal results for NCDOT, including the lowest cost of capital and/or maximum project proceeds for each transaction recommended, the Chief Financial Officer (CFO), and SLGFD will undertake an analysis to determine the recommended coupon and call option structure.

A. Coupon rates generally should be designed to achieve the lowest cost of capital, but parties may consider future call option value when evaluating the costs of capital and may consider the amount of bond proceeds produced by the transaction when determining the preferred coupon structure.

B. Call provisions for NCDOT bond issues will be made as short as possible consistent with the lowest interest cost to NCDOT and credit market acceptability, taking into consideration the option value of such call provisions.

C. When practical and cost efficient, all NCDOT bonds should be callable at par.

VI. Bond Proceeds Expenditures, Reimbursements, Reinvestment, and Arbitrage Rebate

NCDOT's CFO will engage with the SLGFD and applicable Financial Advisors for: 1) a review of the projects being financed and the expected expenditure schedules, and 2) to undertake an analysis to determine which arbitrage rebate spend down tests can be met and correspondingly determine proceed reinvestment strategies.

A. NCDOT generally will strive to issue bonds for project costs expected to be expended in a manner consistent with the two-year spend down test, however the proceeds reinvestment environment may be considered if arbitrage earnings are unlikely.
B. NCDOT will seek to adopt bond reimbursement resolutions in a timely manner such that cash expenditures for eligible project costs can be reimbursed from bond proceeds. Reimbursement resolutions can greatly enhance the ability to meet spend down tests and minimize any arbitrage rebate considerations.
C. Bond proceeds not immediately reimbursed or spent on project costs should be invested for the highest yield but only within the constraints of 1) safety, and 2) adequate liquidity to fund all project costs when needed.
D. NCDOT working with SLGFD will take all steps needed to ensure compliance with all arbitrage rebate regulatory requirements.

VII. Debt Refunding

NCDOT in conjunction with SLGFD staff will monitor the municipal bond market for opportunities to obtain interest savings by refunding or refinancing outstanding debt. As a rule, the present value savings of a particular refunding should equal or exceed 3% of the refunded maturities and not extend the maturity of the outstanding debt. For an advance refunding a higher minimum savings threshold should be considered, depending on how soon the bonds may be called. However, to meet certain restructuring or risk management goals, NCDOT may elect to lower the present value savings threshold for any individual transaction.

VIII. Credit Enhancement and Liquidity

Bond insurance, surety policies, letters of credit, liquidity facilities and other credit enhancements may be used when there is economic savings or risk management opportunities for NCDOT. Letters of credit, liquidity facilities or other credit facilities may expose NCDOT to bank provider risk. In those instances, bank providers should not possess long term credit ratings lower than "A2/A/A" and short-term ratings lower than "P-1/A-1/Fl" from Moody's Investors Services, Standard and Poor's Corporation, and/or Fitch Ratings, respectively.

IX. Continuing Disclosure

NCDOT is committed to providing continuing disclosure of financial and pertinent credit information relevant to NCDOT's outstanding securities and will continue to comply with those provisions of Securities and Exchange Commission Rule 15c2-12 concerning primary and secondary market disclosure. NCDOT, if not already provided via the SLGFD, shall engage the services of Disclosure Counsel to provide guidance and advice to NCDOT and SLGFD concerning securities law and disclosure issues. NCDOT will also coordinate with OSBM as applicable. Additionally, NCDOT will maintain financial information on its website to provide timely information to the market and public. Such information will include, but not be limited to, audited comprehensive annual financial reports, trust agreements, and ratings reports.

X. Credit Objectives

A. It is NCDOT's intent to maintain and improve the credit ratings on its outstanding and proposed bond issues. NCDOT will maintain long-term debt ratings from at least two of the three major bond rating agencies - Moody's Investors Service, Standard and Poor's Corporation, and Fitch Ratings. NCDOT may discontinue the use of ratings from any agency which currently rates the debt of NCDOT if, based on advice from NCDOT's Financial Advisor and underwriting team, the discontinuance of such rating will not adversely affect the interest rates that can be achieved in selling NCDOT's debt without such rating. NCDOT may request that the SLGFD issue non-rated debt on its behalf, for example a bank loan or line of credit, when deemed in the best interest of NCDOT.

B. NCDOT's CFO will maintain frequent communications with the credit rating agencies that currently assign ratings to NCDOT's various debt obligations, and bond insurers that currently enhance any of NCDOT's various debt obligations. This effort must include providing periodic updates on NCDOT's general financial condition along with coordinating meetings, as necessary, in conjunction with a new debt issuance.

XI. On-going Reporting Requirements

A. At least once annually, the CFO will provide the Board of Transportation a report on the status NCDOT's debt. At a minimum, the report must include:
   1. Amount and percentage of total debt by security type
   2. Any changes in ratings, including ratings of credit enhancers and swap counterparties
   3. Current mark-to-market value of all interest rate exchange agreements, if applicable
   4. Historical rate performance for all variable rate bonds, if applicable
   5. Prior to any proposed issuance, confirmation that there is adequate available debt capacity

B. NCDOT's CFO with the assistance of an applicable Financial Advisor, will be responsible for analyzing any unsolicited proposals received relative to debt issues, responding to the proposal as appropriate, and recommending to the BOT any action to be taken in a timely manner.

Scope: This policy applies to all NCDOT employees.

Procedures: N/A

Related Documents: N/A

Revision History		
Revision Date	**Revision Number**	**Description**
1/19/2021	0	Adopted.
9/16/2022	1	Adds clarifying language.

Policy Approval

Signing below certifies that the aforementioned policy has been vetted by the business area representative, applicable legal counsel (AG's office, etc.), and executive staff member(s).

Business Area Representative	DocuSigned by: Stephanie King 5BB78051F6C44CA... *Signature*	09/16/2022 *Date*
Legal Counsel *(Responsible for the Unit)*	DocuSigned by: Daniel Johnson F5F3174344634CB... *Signature*	09/19/2022 *Date*
Secretary of the N.C. Department of Transportation	DocuSigned by: 2CD73228B5AA49B... *Signature*	09/27/2022 *Date*