



SENATE BILL 681: Rural Health Care Stabilization Act.

2019-2020 General Assembly

Committee:	Senate Rules and Operations of the Senate	Date:	June 28, 2019
Introduced by:	Sens. Berger, Tillman	Prepared by:	Erika Churchill
Analysis of:	Second Edition		Staff Attorney

OVERVIEW: *Senate Bill 681 would establish a nonreverting revolving loan fund to provide low-interest loans for the support of hospitals located in rural areas that are in financial crisis, with loan approval by the Local Government Commission (LGC) and loan administration by UNC Health Care. The budget conference report would appropriate \$13,397,000 to the fund in FY19-20 and \$6,603,000 to the fund in FY20-21.¹*

BACKGROUND: The number of rural hospitals struggling with financial sustainability has increased nationally over the past 10 years. The University of North Carolina's Rural Health Research Program tracks closure of rural hospitals across the country. From 2010-2018, there are six states with five or more rural hospital closures; North Carolina saw five closures. From 2005-2016, there were 380 rural hospital mergers; North Carolina saw 18 mergers. This trend is expected to continue.

CURRENT LAW: The appropriation of public funds for health care facilities is an expenditure for a public purpose under Article V, Sec. 2(1) of the North Carolina Constitution if the health care facility is publicly owned. An appropriation of this nature for a health care facility that is privately owned is less clear.² The ability of the State or a local government to borrow funds for the benefit of a health care facility is a more complex issue.

Article V, Sec. 4 of the North Carolina Constitution speaks to the limitations of local government debt:

- Subdivision (2) provides that the General Assembly has no power to authorize a unit of local government to contract debt secured by a pledge of its faith and credit unless approved by the voters, except in limited circumstances.
- Subdivision (3) provides that no unit of local government shall give or lend its credit in aid of any person, association, or corporation, except for public purposes as authorized by general law, and unless approved by the voters.
- Subdivision (5) provides a debt is incurred when a unit of local government borrows money. A loan of credit occurs when a unit of local government exchanges its obligations with or in any way guarantees the debts of an individual, association, or private corporation. A gift of credit is not defined.

¹ See Page I-6 of the Joint Conference Committee Report for HB 966.

² *Foster v. NC Medical Care Commission*, 283 NC 110 (1973).

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Article V, Sec. 8 of the NC Constitution provides that the General Assembly may enact general laws to authorize a unit of local government to issue revenue bonds to finance the cost of acquiring, constructing, and financing health care facility projects to be operated to serve and benefit the public. However, the NC Constitution prohibits the bonds from being secured by a pledge of the full faith and credit, or one deemed to create an indebtedness requiring voter approval. And the NC Constitution is silent as to whether other methods of financing the cost of acquiring, constructing, and financing privately owned health facility projects would be a public purpose.

Voter approval would come in the form of a special election, governed by G.S. 163A-1592. The statute sets the timing for a special election, such as voter approval of debt, as one of the following:

1. At the same time as any other State or county general election.
2. At the same time as the primary election in any even numbered year.
3. At the same time as any other election requiring all the precincts in the county to be open.
4. At the same time as a municipal general election, if the special election is within the jurisdiction of the municipality only.

The county or city calling for the special election must adopt a resolution requesting the county board of elections to conduct the election. After that, legal notice must be given by the county board of elections at least 45 days in advance of the special election.

In North Carolina, the Local Government Finance Act³ requires local governments to receive approval of the LGC before borrowing money. The LGC is composed of nine members: the State Treasurer, the Secretary of State, the State Auditor, the Secretary of Revenue, and five others by appointment of the Governor and General Assembly. The LGC provides assistance to local governments and public authorities in North Carolina. It is staffed by the Department of State Treasurer and approves the issuance of debt for all units of local government and assists those units with fiscal management. The LGC has not approved the issuance of debt by a local unit of government for operating expenses since its inception in 1931.

BILL ANALYSIS: Senate Bill 681 would create a *Rural Health Care Stabilization Program*. The purpose of the Program would be to provide below-market interest-rate loans for the support of hospitals located in rural areas that are in financial crisis due to operation of oversized and outdated facilities and recent changes to the viability of health care delivery in their communities, including the demand for certain patient services and the composition of payer mixes and patient populations. The purpose of the loan would be to help these financially distressed hospitals transition to sustainable, efficient, and more proportionately sized health care service models in their communities.

UNC Health Care would administer the loan program. UNC Health Care could not apply for a loan, could not directly and materially benefit from a loan, and could not be a partner to any partnership that applies for a loan.

Loan proceeds could be used for either, or both, of the following:

1. Financing of construction of new health care facilities.
2. Operational costs during the transition period while the construction of new health care facilities is undertaken.

³ Chapter 159 of the General Statutes.

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The loan process.

- The applicant for a loan must be one of the following:
 - A public agency, including a unit of local government.
 - The owner of a health care facility, which is one or more buildings, structures, additions, extensions, improvements or other facilities, whether or not located on the same site or sites, machinery, equipment, furnishings, or other real or personal property suitable for health care or medical care.
 - A partnership that includes a public agency or the owner of a health care facility.
- The application must be submitted on behalf of an "eligible hospital," which is a health care facility that meets both of the following conditions:
 - Is located in a tier one or tier two development area.
 - Is unable to sustain operations for more than three years from the date of application for a loan under the Program.
- The application is first submitted to UNC Health Care for evaluation to determine if the applicant demonstrates a financially sustainable health care service model for the community in which the eligible hospital is located.
- As part of the application process, the applicant must submit a hospital stabilization plan (Plan) that includes, at a minimum, any proposed changes in governance or ownership of the hospital and the hospital's financial projections. UNC Health Care may assist the applicant with revisions to its Plan.
- Based on its evaluation of the loan application and Plan, UNC Health Care would recommend approval or disapproval of the loan to the LGC, as well as the terms of the loan.
- An award of a loan may not be made under the Program unless the LGC approves it.
- The LGC would review UNC Health Care's recommendation, an applicant's Plan, and any other information it may believe to have a bearing on whether the loan should be approved. Its consideration process would be substantially similar to the consideration process the LGC uses to assess the feasibility of local financing agreements.
- If UNC Health Care recommends disapproval of a loan application, the applicant may engage a disinterested and qualified third party approved by the LGC to evaluate the application and Plan. The LGC could consider the third party's evaluation.
- If the LGC enters an order approving the loan, UNC Health Care is to execute the terms of the loan agreement, and any debt instrument to evidence that agreement. The terms of the loan agreement may include changes to the governance structure of the hospital. The interest rate must be below the market rate, and the maximum maturity for the loan is seven years.
- If the LGC enters an order denying the loan, the proceedings under this Article end.

UNC Health Care must report annually on the Rural Health Care Stabilization Fund to the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division.

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The application of the current law.

Senate Bill 681, in conjunction with the Budget Conference Report, appropriates \$20 million to the Rural Health Care Stabilization Fund to be used for the support of health care facilities located in tier one and tier two counties. The appropriation by the State and use of these public funds for a public health care facility is a public purpose under Article V, Sec. 2(1) of the NC Constitution, and might be considered a public purpose if the health care facility is a private one.

The parameters of the loan program authorized under Senate Bill 681 are left broad so that a loan agreement could be structured in a variety of ways. The legal questions surrounding the loan agreement will vary depending upon the recipient of the loan and the use of the loan proceeds. Some of the questions that may need to be considered by the parties in executing a loan agreement may include:

- If the loan agreement is between the State and a public health care facility, the questions surrounding public purpose and debt limitations would not have to be considered.
- If the loan agreement is between the State and a private health care facility, the analysis would involve at least the following questions:
 - Is the appropriation for a public purpose?
 - Does Article V, Sec. 8 require any indebtedness to be financed as revenue bonds? And if so, does the loan need to be negotiated at arms-length and be made at a fair market rate on commercially reasonable terms?⁴
- If the loan agreement is between the State and a unit of local government, the legal analysis of the transaction is more complicated and the NC Constitutional limitations on local government debt will need to be considered, as well as how the loan proceeds would be used. The analysis would involve at least the following questions:
 - In addition to the questions noted above, would the loan have to be structured so as not to implicate the taxing power of the unit of local government, unless there was a vote of the people?
 - Would the borrowing be governed by Article V, Sec. 8? And if so, would a loan agreement with the State where the debt of the unit of local government is secured by revenues received by the private health care facility suffice?
 - Are the proceeds used in a manner that would be considered a loan of credit from the unit of local government to the health care facility, requiring approval by the voters of the local government?
 - Are the proceeds used in a manner that would be considered a gift of credit from the unit of local government to the health care facility, requiring approval by the voters of the local government? The NC Constitution does not define a gift of credit.
 - Will the unit of local government have to take an ownership interest in the health care facility to satisfy constitutional requirements?

EFFECTIVE DATE: The bill becomes effective July 1, 2019.

⁴ [Attorney General's opinion, February 19, 2002.](#)