



# SENATE BILL 681: Rur Hlth Care/Loc. Sales Tax Flex/Util. Acct.

2019-2020 General Assembly

<b>Committee:</b>	House Finance. If favorable, re-refer to Rules, Calendar, and Operations of the House	<b>Date:</b>	July 24, 2019
<b>Introduced by:</b>	Sens. Berger, Tillman	<b>Prepared by:</b>	Cindy Avrette
<b>Analysis of:</b>	PCS to Second Edition S681-CSSVxfr-36		Erika Churchill Staff Attorneys

**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.<sup>1</sup>*

*The proposed House committee substitute would do the following:*

- *Change the maturity of the loan from a maximum of seven years to a maximum of twenty years, stipulate that the interest rate could not exceed the interest rate obtained by the State on its most recent general obligation bond offering, clarify that the Fund is a State fund, and change the effective date to when the act becomes law.*
- *Add the contents of H667, Local Option Sales Tax Flexibility,<sup>2</sup> which would provide counties with the flexibility to levy, by referendum, an additional quarter-cent local sales tax as long as the total overall rate does not exceed the current maximum rate allowed for that county and would allow counties to identify the use of the proceeds in the ballot question as being for any public purpose, for public education purposes, or for some combination of the two.*
- *Add the contents of H258, Expand Eligibility for Utility Account,<sup>3</sup> which would expand the counties eligible for grants from the Utility Account from the 80 most-distressed counties under the tier system to the 87 most-distressed counties.*

## PART I. RURAL HEALTH CARE STABILIZATION PROGRAM

**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

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

<sup>2</sup> This bill passed the House on May 16, 2019.

<sup>3</sup> This bill passed the House on May 6, 2019.

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Director



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clear.<sup>4</sup> 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. 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.

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.

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 Act<sup>5</sup> 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:** Part I. of the PCS 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

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<sup>4</sup> *Foster v. NC Medical Care Commission*, 283 NC 110 (1973).

<sup>5</sup> Chapter 159 of the General Statutes.

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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.

## **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.

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- 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 may not exceed the interest rate obtained by the State on its most recent general obligation bond offering. Interest rates on GO bonds is the most favorable interest rate available. The maturity for the loan may not exceed ten years, with an option to extend the loan for a second ten-year period.
- 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.

## **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 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?<sup>6</sup>
- 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?

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<sup>6</sup> [Attorney General's opinion, February 19, 2002.](#)

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- 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?

## PART II. LOCAL OPTION SALES TAX FLEXIBILITY

### CURRENT LAW:

**Generally.** – The local sales and use tax rate varies among the counties, ranging from 2% to 2.75%.<sup>7</sup> Under current law, there are 6 counties that *could* have a total local sales and use tax rate of two and three-quarters (2.75%), for a total State and local rate of 7.5%. Those counties are: Durham, Forsyth, Guilford, Mecklenburg, Orange, and Wake.<sup>8</sup> Only 2 counties are levying at that rate: Durham and Orange. The maximum that may be levied in the other 94 counties is two and one-half percent (2½%). The reason for the difference is that those 94 counties may only levy a one-quarter cent (¼%) tax for public transportation. The remaining local taxes for those counties are the same.

**Public Transportation (Article 43).** – Counties may levy, upon referendum, a local sales and use tax to be used only for public transportation if the county or at least one unit of local government in the county operates a public transportation system. "Public transportation system" is broadly defined as any combination of real and personal property established for purposes of public transportation, but specifically excludes streets, roads, and highways (except to the extent they are dedicated to public transportation vehicles). The rate of tax that may be levied for this purpose is ½% for the following six counties: Durham, Forsyth, Guilford, Mecklenburg, Orange, and Wake.<sup>9</sup> The rate of tax that may be levied in all other counties is ¼%.

Currently, the only counties levying a tax under this Article are Mecklenburg,<sup>10</sup> Durham,<sup>11</sup> Orange,<sup>12</sup> and Wake<sup>13</sup> Counties. None of the 94 counties levy the ¼¢ tax under this Article.

**"General Purpose" Quarter-Cent Tax (Article 46).** – In 2007, the General Assembly gave counties a local-option, quarter-cent sales tax. The tax must be approved by voters in a referendum before it can be adopted. The proceeds of the tax are not shared with the cities and may be used for any public purpose. Food is not included in the base to which the tax applies. Since the enactment of the authorization, at least 159 referenda have been held in approximately 75 counties. Of those, 42 were approved.

**BILL ANALYSIS:** Part II of the PCS does the following:

### **Changes to Article 46: One-Quarter Cent (¼¢) County Sales and Use Tax**

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<sup>7</sup>See Table #2 in the **BACKGROUND** section of this Bill Analysis for a listing of current local option sales and use tax rates in all 100 counties.

<sup>8</sup> To reach the maximum, a county would have to levy the first cent, the first one-half cent, the second one-half cent, the one-half cent public transportation tax, and the one-quarter cent tax. To date, only 2 of these 6 counties levy the maximum: Durham and Orange.

<sup>9</sup> Of these six counties, Durham and Orange are the only ones that also levy the quarter-cent tax under Article 46.

<sup>10</sup> Mecklenburg County passed a one-half cent sales tax for transit, with 58% of the voters in favor, in November 1998. The county began levying the tax April 1, 1999.

<sup>11</sup> Durham County passed a one-half cent sales tax for transit, with 60% of the voters in favor, in November 2011. The county began levying the tax April 1, 2013.

<sup>12</sup> Orange County passed a one-half cent sales tax for transit, with 59% of the voters in favor, in November 2012. The county began levying the tax April 1, 2013.

<sup>13</sup> Wake County passed a one-half cent sales tax for transit, with 53% of the voters in favor in November 2016. The county began levying the tax April 1, 2017.

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**Section 2.1** would modify the current Article 46 as follows:

- It would increase from ¼% to ½% the maximum rate of tax that may be levied under this Article.
- It would also provide that the maximum rate that a county may levy under any combination of local option sales taxes is 2 1/2 % for most counties and 2 3/4% for the 6 counties that currently have that maximum.
- It would allow counties the option of specifying in the ballot question the use of the proceeds of the tax to be either any public purpose, to be limited to public education purposes, or to be used for a combination of those purposes.

"Public education purposes" is defined in the bill as follows:

- Public school capital outlay purposes or to retire any indebtedness incurred by the county for these purposes.
- Supplements of classroom teacher salaries. A classroom teacher is an employee of a local board of education employed as a teacher who spends at least seventy percent (70%) of his or her work time in classroom instruction.
- Financial support of community colleges, including funds to supplement State financial support of community colleges.

## **Changes to Article 43: Local Government Sales and Use Tax for Public Transportation**

**Section 2.2** does not make any substantive changes to the Article 43 tax other than to provide that the maximum rate that a county may levy under any combination of local option sales taxes is 2 1/2 % for most counties and 2 3/4% for the 6 counties that currently have that maximum.

**Section 3.3** makes a conforming change to ensure that the combined general rate is not affected as the result of changes to Article 46.

**BACKGROUND:** The following tables set out details of each of the local option sales tax authorizations, including the purposes for which the proceeds may be used, whether the proceeds are shared with the cities, which articles are currently subject to the adjustment factor, and the various taxes that the counties are currently levying:

**Table 1: Local Option Sales & Use Tax Articles in the North Carolina General Statutes, Chapter 105**

Article	Rate	Levied By	Distribution	Adjustment Factor (G.S. 105-486)?	2015 Redistribution?	Restrictions	Shared with Cities?	Enacted
39	1¢	100 counties	Point of Destination	No	Yes	None	Yes	1969
40	½¢	100 counties	Per Capita	Yes	Yes	30% of a county's proceeds must be used for school capital.	Yes	1983
42	½¢	100 counties	Point of Destination	Yes, food portion only	Yes	60% of a county's proceeds must be used for school capital.	Yes	1986
43	¼¢ ½¢	0 counties Durham, Mecklenburg, Orange, Wake	Point of Destination	No	No	Transit	If the city operates a transit system.	1997
46	¼ ¢	42 counties	Point of Destination	No	No	None	No	2007

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**Table 2. County Tax Rates**

County						Tax Rate	Articles Levied	
<b>56 Counties Have a Total Sales &amp; Use Tax Rate of 6.75%</b>								
Alamance	Carteret	Forsyth	Johnston	Pender	Union	2.00% local	- Art. 39, 40, & 42	
Alleghany	Caswell	Franklin	Lenoir	Perquimans	Vance	+ 4.75% State		
Avery	Chatham	Gates	Macon	Person	Warren	6.75% Tax		
Beaufort	Chowan	Granville	Madison	Polk	Washington			
Bertie	Cleveland	Guilford	McDowell	Richmond	Watauga			
Bladen	Columbus	Henderson	Mitchell	Scotland	Wayne			
Brunswick	Craven	Hoke	Nash	Stokes	Wilson			
Burke	Currituck	Hyde	Northampton	Transylvania	Yadkin			
Caldwell	Dare	Iredell	Pamlico	Tyrrell	Yancey			
Camden	Davie							
<b>40 Counties Have a Total Sales &amp; Use Tax Rate of 7.00%</b>								
Alexander	Clay	Greene	Lee	Pasquotank	Rowan	2.25% local		- Art. 39, 40, & 42
Anson	Cumberland	Halifax	Lincoln	Pitt	Sampson	+ 4.75% State		- Art. 46
Ashe	Davidson	Harnett	Martin	Randolph	Stanly	7.00% Tax		
Buncombe	Duplin	Haywood	Montgomery	Robeson	Surry			
Cabarrus	Edgecombe	Hertford	Moore	Rockingham	Swain			
Catawba	Gaston	Jackson	New Hanover	Rutherford	Wilkes			
Cherokee	Graham	Jones	Onslow					
<b>2 Counties Have a Total Sales &amp; Use Tax Rate of 7.25%</b>								
Mecklenburg						2.50% local	- Art. 39, 40, & 42	
Wake						+ 4.75 State	- Art. 43 at ½¢	
						7.25% Tax		
<b>2 Counties Have a Total Sales &amp; Use Tax Rate of 7.50%</b>								
Durham						2.75% local	- Art. 39, 40, & 42	
Orange						+ 4.75% State	- Art. 43 at ½¢	
						7.50% Tax	- Art. 46	

### PART III. EXPAND ELIGIBILITY FOR UTILITY ACCOUNT

**CURRENT LAW:** G.S. 143B-437.08 ranks counties into 3 tiers based on 4 factors: (1) average unemployment rate for the most recent 12 months for which data are available; (2) median household income for the most recent 12 months for which data are available; (3) percentage growth in population for the most recent 36 months for which data are available; and (4) adjusted property tax base per capita for the most recent taxable year.

Counties are assigned to a tier where the 40 most-distressed counties are designated Tier One; the next 40 counties are Tier Two; and the 20 least-distressed counties are Tier Three.

G.S. 143B-437.01 creates the Industrial Development Fund Utility Account (Utility Account) to provide funds to assist the local government units of the 80 most economically distressed counties (i.e., development tier one or two area under G.S. 143B-437.08) in creating jobs. The funds must be used for construction of or improvements to new or existing water, sewer, gas, telecommunications, high speed broadband, electrical utility distribution lines or equipment, or transportation infrastructure for existing or new or proposed buildings. The funds may not be used for any retail, entertainment, or sports projects. The program is governed by additional statutory rules and also by regulations adopted by the Department of Commerce.

In addition to the projects located in the 80 most economically distressed counties, the Secretary of Commerce may use up to \$100,000 to provide emergency economic development assistance in any county

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that experiences a major economic dislocation (defined as the actual or imminent loss of 500 manufacturing jobs or 10% of the existing manufacturing workforce in the county).

G.S. 143B-437.56 diverts a percentage of a Job Development Investment Grant Program (JDIG) award to the Utility Account as follows: 25% of the award in tier three area, 10% of the award in a tier two area. Special rules apply to certain JDIG awards.

**BILL ANALYSIS:** Part III. of the PCS would expand the counties eligible for grants from the Utility Account from the 80 most-distressed counties (i.e., 40 tier-one counties plus 40 tier-two counties) to the 87 most-distressed counties under the tier system.

**EFFECTIVE DATE:** The bill is effective when it becomes law.