



**Report on Historic Charters**  
**Presented to the North Carolina General Assembly**  
**By the North Carolina Department of State Treasurer**  
**January 15, 2021**

**SECTION 1. INTRODUCTION**

North Carolina Session Law 2020-79 (enacted on July 1, 2020) Part 1, Section 5, requires:

The Department of State Treasurer shall study and make recommendations as to the feasibility of authorizing historical charters for units of local government that have become, or are on the brink of becoming, defunct. The study shall specifically examine whether these historical charters are needed, the impact of these charters on the bond rating of the State and its political subdivisions, and the consequences of these historical charters. No later than January 15, 2021, the Department of State Treasurer shall report its findings and recommendations to the General Assembly.

Section II through Section V of the following report seek to address the issues raised by the legislation while Section VI presents the Department of State Treasurer's recommendations regarding historic charters.

**SECTION II. FEASIBILITY OF HISTORIC CHARTERS**

The North Carolina Constitution grants the General Assembly the sole authority to give powers and duties to the State's municipalities and other subdivisions. Specifically, Article VII, Section 1 states:

The General Assembly shall provide for the organization and government and the fixing of boundaries of counties, cities and towns, and other governmental subdivisions, and, except as otherwise prohibited by this Constitution, may give such powers and duties to counties, cities and towns, and other governmental subdivisions as it may deem advisable

Although the legal framework for historic charters is established within the General Assembly's constitutional authority, the feasibility of historic charters must be considered beyond that authority. Most importantly, a historic charter would only be feasible if another local



government, such as a larger municipality or a county, is fiscally sound and sufficiently managed to assume the governance offered to the citizens of the historic charter unit as well as potentially some or all of the services. Further, it is recommended that a historic charter be granted only if an agreement is developed that would address the management, financial, and operational considerations introduced by the historic charter. The agreement would need to address issues including but not limited to:

- Continued provision of services in some manner such as police protection, fire protection, solid waste collection and/or disposal, water distribution, sewer collection and disposal, street maintenance, street lighting, and zoning, as appropriate and applicable;
- Disposition of public assets such as buildings, motor fleets, cash and investments;
- Payables and outstanding debt;
- Municipal ordinances; and
- Board composition and authority.

Finally, although the General Assembly has the authority to take actions related to “counties, cities and towns, and other governmental subdivisions”, the concept of charters and therefore historic charters is applicable only to municipalities, which are the focus of this report.

### **SECTION III. NEED FOR HISTORIC CHARTERS**

Local governments throughout the State are facing a variety of challenges requiring a variety of solutions. For units with distressed water/wastewater systems, Viable Utility Reserve legislation and associated funding may offer the most effective long-term solutions. For small units of local government struggling to meet their fiscal management obligations, changes to existing legislation or the development of additional resources by the North Carolina League of Municipalities or the North Carolina Association of County Commissioners may offer targeted solutions for those units. Historic charters would serve as another solution for local governments, specifically municipalities, facing financial or fiscal management challenges.

It is important to note that in many cases historic charters could not and would not remedy the underlying issues that precipitated the need for consideration of a historic charter or other long-term solution for struggling municipalities. Municipalities with aging utility systems, for example, cannot simply be granted a historic charter to remedy their financial or fiscal management challenges; solutions for the continued operation, merger, or dissolution of the system must be analyzed and implemented. The need for and application of historic charters as a solution for struggling municipalities must be considered with these limitations in mind.



Historic charters would be a valuable option for two different groups of municipalities; note that some may fall into both groups:

- those that face financial challenges and are unable to meet the needs of their citizens; and
- those that face fiscal management challenges and are unable to meet the statutory obligations outlined in the Local Government Budget and Fiscal Control Act.

*Municipalities facing financial challenges –*

Economic, demographic, and geographic challenges continue to erode the ability of some municipalities to meet the essential needs of their citizens. Loss of businesses and jobs, shrinking populations, and declining tax bases may result in the inability to raise sufficient revenues to maintain operations. These challenges, along with aging infrastructure, are beyond the scope of control of these municipalities and their governing bodies and often leave these communities struggling for financial survival.

*Municipalities facing fiscal management challenges -*

Some municipalities have encountered challenges in meeting their obligations under the Local Government Budget and Fiscal Control Act. Inexperienced staff, staff turnover, and/or lack of governing body engagement may lead to failure to comply with the Act's requirements including maintaining accurate accounting records, ensuring the timely completion of annual audits, and other fiscal management functions. While occasional lapses in fulfilling specific fiscal management responsibilities are not necessarily cause for significant concern, municipalities that repeatedly fail, over a period of years, to comply with provisions of the Act are signaling an inability to provide effective oversight of public funds and are not serving the best interests of their citizens.

The Unit Assistance List (UAL), developed and issued annually by the Department of State Treasurer, can be used to develop an estimate of the number of municipalities in each of the groups described above. The UAL includes any unit with a score of 3 (low risk), 2 (moderate risk), or 1 (high risk) in each of three categories: internal control issues, general fund financial issues, and water/sewer fund financial issues. Scores are determined based on an analysis of audited financial data as well as other information known to the Department of State Treasurer about the units' financial health and management. 95 municipalities (out of 552 municipalities in North Carolina) are included in the most recent version of the UAL (December 1, 2020).

Those municipalities on the UAL with a general fund or water/sewer fund risk assessment score of 1 (high risk) would be included in the first group – those facing financial challenges. The most recent version of the UAL includes 44 municipalities with a score of 1 in their general fund or water/sewer fund.



Those municipalities on the UAL with an internal control risk assessment score of 1 (high risk) would be included in the second group – those facing fiscal management challenges. The internal control score is determined based on auditors’ findings in the annual audit and indicates a deficiency on the part of the unit to adequately perform and manage basic accounting functions and safeguards. The most recent version of the UAL includes 43 municipalities with a score of 1 for internal control issues.

Note that there is an overlap in high risk scores, with 23 municipalities receiving a score of 1 for internal control issues as well as a score of 1 for issues in their general fund and/or water sewer fund. These units would be considered most at risk due to the combination of high-risk scores both in internal controls as well as their major operating fund(s).

An additional 20 municipalities on the UAL had not yet submitted their fiscal year 2019 annual audit as required by North Carolina G.S. 159-34(a) as of the publication date of the UAL - over one year past the deadline of October 31. Since the UAL’s risk assessment scores are based on financial information in the annual audit report, these municipalities are not scored on the UAL but are included due to their failure to submit annual audit. An annual audit report provides essential information on the financial condition of the municipality to its governing body and citizens, and failure to submit a timely audit report indicates issues of significant concern.

Although the UAL provides a starting point for identifying municipalities that could benefit from a historic charter, inclusion on the UAL should serve only as one input into a more thorough analysis of the need for and benefit of a historic charter.

#### **SECTION IV. IMPACT OF HISTORIC CHARTERS ON BOND RATING OF THE STATE AND ITS POLITICAL SUBDIVISIONS**

In most cases, municipalities that are likely candidates for historic charters would not have outstanding public debt and therefore would not have an assigned bond rating. The latest release of the Unit Assistance List (as of December 1, 2020) includes 95 municipalities and none has a bond rating assigned by any of the three main rating agencies – Fitch, Moody’s, or S&P.

This report cannot make assurances as to the actions taken by ratings agencies in the event the General Assembly enacts historic charter legislation. It is recommended, however, that any legislation should require a historic charter agreement between the historic charter unit and the assuming unit that would ensure no net negative impact on the fiscal stability or outlook of the assuming unit; this agreement could mitigate any real or perceived impact on an assuming unit and its bond rating, should it have one.

With regards to the bond rating of the State, again, assurances cannot be made; however, historic charter legislation may be viewed positively as building on the State’s longstanding commitment



to strong fiscal oversight of local governments. Historic charters also would allow the State to proactively address distressed local governments and avoid municipal bankruptcies thereby continuing the State's reputation for responsible stewardship of taxpayer dollars.

## **SECTION V. CONSEQUENCES OF HISTORIC CHARTERS**

Historic charters could provide positive outcomes for municipalities that face long-term challenges in meeting their financial and fiscal management obligations. Under a historic charter, a municipality would retain its name, its historic identity, and its sense of community. The granting of a historic charter would not be a short-term solution nor entered into lightly, but only undertaken as a means of ensuring that the needs of the municipalities' citizens are met long-term. The potential consequences for local governments – either larger municipalities or counties - assuming historic charter units must be thoroughly analyzed on a case-by-case basis and addressed in an agreement prior to a historic charter being granted. The goal of the agreement must be to ensure that all management, financial, and operational considerations are addressed and that the assuming unit incurs no negative financial or other consequences as a result of the historic charter.

## **SECTION VI. RECOMMENDATIONS**

The Department of State Treasurer recommends historic charters as a means of providing the State with an option for municipalities that face long-term financial and/or fiscal management challenges that threaten their viability as local governments and their ability to serve the best interests of their citizens. Municipalities would benefit from historic charters by being relieved of their financial management obligations while retaining their name, historic identity and sense of community. Additionally, historic charters would continue the State's position as a leader in local government fiscal oversight and build on its reputation of providing innovative and effective solutions that benefit local governments and the State. The Department makes the following additional recommendations:

### *Identification of Municipalities for Historic Charter Consideration –*

Three methods for identifying municipalities for historic charter consideration are proposed:

- 1) As the entity charged by the General Assembly with monitoring the fiscal health of local governments, the Local Government Commission (LGC) is best positioned to oversee identification of municipalities for potential historic charter action. The LGC would develop criteria, including scores from the UAL along with factors such as economic and



demographic trends and other information known to the LGC, to assess the long-term viability and management of these potential candidates. Based on these assessments, the LGC would identify municipalities for historic charter consideration.

- 2) A provision also should be provided for municipalities that wish to directly petition the LGC for a historic charter. These municipalities may have specific circumstances or information regarding their finances, governance, or other concerns that would lead them to seek a historic charter designation.
- 3) In cases where the LGC has exercised its authority under North Carolina G.S. 159-181 and has assumed control of the financial affairs of a municipality, the LGC would determine if a long-term solution to the financial and fiscal management challenges could be met by a historic charter. If the LGC determines that a municipality and the State would be best served by a historic charter, the LGC could recommend the municipality for consideration.

Whether identified by means of assessment criteria, direct petition by a municipality, or LGC recommendation for municipalities under its financial control, municipalities would be presented annually by the LGC to the Joint Legislative Committee on Local Government for a determination of historic charter. For each municipality recommended for historic charter, the LGC would present information including:

- the basis for the LGC's recommendation;
- the local government that would assume the historic charter unit;
- the target date for the historic charter;
- an agreement between the historic charter unit and the assuming unit addressing financial, operational, legal, governance, and other issues (as detailed in Section II).

The General Assembly could then accept or choose not to act on the historic charter recommendation.

#### *Legislation –*

The action of granting a historic charter, much like suspending or revoking a charter, would not be an action to be taken lightly, and would need to be based on a clear and compelling need that addresses the best interests of the local government involved as well as the State. It is recommended that any legislation addressing historic charters would require that all potential financial, operational, legal, governance, and other issues are examined upon identification of municipalities recommended for historic charter. Further, it is recommended that agreements between historic charter units and assuming units must be in place prior to a historic charter



being granted to ensure that these issues are adequately addressed, that citizens are assured of uninterrupted service and governance, and that the assuming unit faces no negative financial or other consequences of the historic charter. Additional legislation may be required to allow assuming units to effectively meet the requirements of these agreements as well as to provide statutory relief for units that have failed to meet provisions of the Local Government Budget and Fiscal Control Act and for which it is not fiscally or practically prudent to require compliance prior to the grant of a historic charter.

#### *Return to Full Charter –*

Because of the significance of a historic charter and the effort and expense that would be required to develop and implement a comprehensive agreement between the historic charter unit and the assuming unit, it is recommended that any historic charter municipality that wishes to subsequently revert to a full charter be required to wait a minimum of two years before reapplying for an active charter through the process currently established in North Carolina General Statutes Chapter 120, Article 20, Part 2. Further, it is recommended that North Carolina G.S. 120-163(c) be amended to include a requirement that a petition for municipal incorporation include a statement from the LGC regarding the proposed municipality's prospects for financial viability and effective fiscal management.

#### *Resources –*

The process of identifying municipalities for historic charter consideration, including risk analysis and other oversight, as well as the development and implementation of historic charter agreements, will require significant Department of State Treasurer staff time therefore introducing the need for additional staff. Further, funding may be required to address one-time costs associated with historic charters such as legal or accounting services or costs associated with the assumption or transition of services or debt, and to ensure that the assuming unit incurs no financial harm as a result of the historic charter.

#### *Solutions for Other Distressed Units of Local Government –*

This report has focused on the feasibility and implementation of historic charters as a solution for distressed municipalities. Other types of units of local government such as counties and public authorities (including water/sewer authorities) may face similar financial and fiscal management challenges. Although those units' challenges are beyond the scope of this report, it is



recommended that municipal historic charters serve as a pilot for developing legislation or other initiatives to identify and develop long-term solutions for other types of local governments.

#### *Modification to North Carolina G.S. 105-472 –*

North Carolina G.S. 105-472 requires counties to adopt a resolution in April of each year determining the distribution method for the net proceeds of taxes collected (as defined in 105-472) – either per-capita or ad valorem. The resolution is in effect for the immediately succeeding fiscal year beginning July 1. If counties choose to modify the distribution method, the timing of the resolution requirement provides municipalities with little time to respond to what may be a significant and even devastating impact on their revenue, and often comes during the municipalities' own budget development process. It is recommended that this statute be modified to require that the county resolutions adopted in April of each year be in effect for the fiscal year following the immediately succeeding fiscal year, that is, approximately 14 months after the resolution is adopted by a county. This delay in implementation would allow municipalities sufficient time to address and budget for the change in revenue, or take other actions as appropriate, up to and including petitioning for a historic charter.

## **SECTION VII. CONCLUSION**

The North Carolina General Assembly established the Local Government Commission in 1931 to help address the financial challenges faced by local governments as a result of the Great Depression. That action led to 80+ years of strong local government financial oversight, and resultant benefits including above average debt ratings for local governments, a triple-A rating for the State from all three ratings agencies, lower cost of borrowing for North Carolina taxpayers, and confidence in North Carolina's debt market and the fiscal health of its over 1,300 units of local government.

The State now faces new challenges as economic, demographic, and other changes have threatened the viability of some local governments. Viable Utility Reserve legislation passed by the General Assembly in 2020 provides a framework and funding to begin to address the needs of distressed units with water/wastewater systems, but assistance is also needed for local governments without these utility systems. 2021 marks the 90<sup>th</sup> year since the creation of the LGC and presents an opportunity for the General Assembly to again take action, through historic charters, to address the needs of local governments and the citizens of the State.



## **SECTION VIII. ACKNOWLEDGEMENTS**

The Department of State Treasurer wishes to acknowledge State Auditor Beth Wood, the North Carolina League of Municipalities, and the North Carolina Association of County Commissioners for their input and collaboration on this report.