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Comments on the Latest Round of Draft Maturity Guidelines

Dear Robin:

In this letter I provide my comments on the latest draft resolution concerning maturity guidelines.

To state that these guidelines "document existing practice" is incorrect with respect to USDA refinancings and in certain other respects.

In December 2012, the Commission approved a refinancing for Hyde County that did not comport with the guidelines. This refinancing was simply the latest in a line of dozens of similar "non-conforming" refinancings of USDA loans, dating back at least to the mid-1980s, that the LGC routinely approved. In January 2014, a client of mine was informed that a refinancing not meeting these new rules would not be approved – would not even be presented to the Commission – because the rules were changing.

Further, the very fact that the Commission staff is taking comments, and making changes to the proposed guidelines in response to the comments, supports the conclusion that the guidelines do not seek simply to document existing practice.

The guidelines are in fact "rules" under North Carolina's administrative procedure act, and the Commission may not continue to enforce these rules until they have been approved under the required procedures.

These guidelines are certainly a "statement of general applicability . . . that describes the procedure or practice requirements of an agency," which is the definition of a "rule" in Gen. Stat. Section 150B-2(8a). Without any doubt, the guidelines "directly" and "substantially affect the procedural or substantive rights" of entities outside the agency of the Department of State Treasurer. Further, these guidelines do not meet the criteria for any of the exceptions set out in that statute for something to be not a rule. Stating that a policy "documents existing practice" or is part of an "internal policy project" does not

change that "policy" from something that *is a rule* and turn it into something that *is not a rule*. DST has offered no other explanation as to why these policies would not be "rules" under the terms of the statute, but the offered explanations simply don't address the statutory requirements.

A rule that is not approved through the statutory process may not be applied by the sponsoring agency. Gen. Stat. Section 150B-18. The Commission's staff has been enforcing these guidelines for some time now in contravention of this prohibition.

I understand that many agencies find the statutory rulemaking process awkward and limiting, and find the oversight imposed by the Rules Review Commission to be burdensome. Nevertheless, the law exists and applies to this case. In my opinion, many of the concepts embodied in the guidelines are suitable for rules that could certainly be approved. By not following the statutory procedure, DST runs the risk of later losing a challenge to the rules – the consequences could range from simple embarrassment to losing the right to impose certain rules – that could easily be avoided.

The guidelines appear intended to limit a unit's right to have the Commission consider an application that does not comport with the guidelines, in contravention of statutory protections.

If that is not the intent, it would be a welcome addition to state that "nothing in these guidelines is intended to eliminate a unit's right to make an application, to have it presented to the Commission and for any proposed denial to be subject to notice and a hearing as provided in the General Statutes." See, for example, Sections 159-53 and 159-152.

As applied to USDA refinancings, the guidelines change previous policy and cut off a route to savings that has saved dozens of units millions of dollars over the years.

As noted above, Hyde County completed a USDA refunding in December 2012 that would not meet the proposed guidelines. This refinancing saved Hyde County, its taxpayers and ratepayers over $340,000 on a present value basis. The Commission was right to approve that loan and to allow the County the benefit of those savings.

In October 2012, Pender County completed a comprehensive refinancing of USDA loans that would not meet the proposed new guidelines. This refinancing saved Pender County, its taxpayers and ratepayers over $2,100,000 on a present value basis (over $4,600,000 on a nominal dollar basis). The Commission was right to approve that loan and to allow the County the benefit of those savings.

The guidelines represent a substantial change in policy with no articulation of the policy basis for a change. USDA refinancings should simply be held to the same standards as any other refinancing – a 3% present value savings requirement with no deferral of principal and no front-loading of the savings. Only in the case of a USDA refinancing must a borrower show both a reduction in the loan term and a reduction in annual payments. There is no appropriate basis for uniformly applying stricter rules to USDA refinancings. By applying stricter rules to these financings, the guidelines have the acknowledged result of routinely denying refinancing savings to a select group of borrowers that tend to be lower-resource and more in need of the help.

Just look at the illogical results of applying the guidelines: a unit with 25 years left on a 40-year loan can't do a 15-year refinancing and capture savings, because the new term – even though ten years shorter (in this example, 40% shorter) than the existing term – will be too long. And in the last half of a 40-year loan, refinancing may be completely prohibited, no matter how much in savings the unit could realize. These kinds of extraordinary results should be backed by extraordinary policy justifications, and those have not been articulated.

The guidelines are also overbroad in their treatment of original USDA loans. Note that these guidelines would apply even if USDA has sold the original loan to another bondholder, as USDA has done from time to time over the years. Note that these guidelines would apply even if USDA has directed the unit to refinance the loan with another funder (as USDA generally has the right to do under its agreements with its borrowers). Note that these guidelines would prevent a refinancing of USDA loans even in connection with improvements or expansions to a USDA-financed facility or system that might no longer be eligible for USDA refinancing and which therefore might block additional borrowing. Note that under these guidelines, only for USDA borrowers does the LGC substitute its judgment for that of local elected officials as to whether a refinancing is best arranged by reducing payments or shortening a loan term.

There is certainly no reason that LGC staff cannot work closely with the borrower so that the LGC is comfortable with the unit's repayment plan, and is comfortable that the unit is aware of what it is giving up (such as the right to free prepayment) and gaining (such as the possible release of a debt service reserve fund, along with other savings) through the refinancing – this is part of the routine on any financing. But the Commission staff is wrong to believe it can, right now, establish blanket rules that will always be the best approach to USDA refinancings for all borrowers – and there is no reason to try to establish such rules, when the existing system has well served the State and the local governments for so many years.

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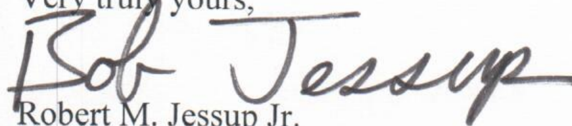
Please let me know if you have any questions or comments for me about the material in this letter.

Very truly yours,



Robert M. Jessup Jr.