CITY OF MONROVIA FILE NO. 2.92

ADMINISTRATIVE POLICY

SUBJECT: Debt Management Policy

EFFECTIVE DATE: January 17, 2017

I. Policy Objective:

To establish guidelines and parameters for the effective governance, management and administration of debt and other financing obligations issued by the City and its related entities (such as the Monrovia Financing Authority, the Successor Agency to the Monrovia Redevelopment Agency, and the Monrovia Housing Authority) and to ensure compliance with California Government Code Section 8855, and other legislation, statutes, and laws that place regulations on local agency debt. Pursuant to California Government Code Section 8855, the following five elements have been incorporated into this policy:

1. The purposes for which the debt proceeds may be used;
2. The types of debt that may be issued;
3. The relationship of the debt to, and integration with, the issuer’s capital improvement program or budget, if applicable;
4. Policy goals related to the issuer’s planning goals and objectives; and
5. The internal control procedures that the issuer has implemented, or will implement, to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

As used in this Policy, “City” shall mean the City and/or the City and its related entities, as the context may require.

II. Authority

City Council Resolution No. 2017-02 (Adopted January 17, 2017)

III. Assigned Responsibility

City Manager and the Administrative Services Director

IV. Applicability:

City Manager, Administrative Services Director, and Finance Department staff

V. General Policy

With certain exceptions, the California Constitution requires cities to obtain approval by two-thirds of its voters to encumber public funds beyond the current fiscal year. The three major exceptions to the constitutional debt limit for which a city is not required to obtain voter approval are (1) obligations secured by and payable solely from special funds, (2) obligations imposed by law, and (3) lease obligations. As used in this Policy, “debt” shall be interpreted broadly to mean bonds, notes, certificates of participation, financing leases, or other financing obligations, but the use of such term in this Policy shall be solely for convenience and shall not be interpreted to characterize any such obligation as an indebtedness or debt within the meaning of any constitutional debt limitation.

VI. Acceptable Uses of Proceeds of Debt and Factors for Capital Financing

1. The City will consider the use of debt financing only for one-time capital improvement projects and only under the following circumstances:

    a. When the weighted average maturity of the debt does not exceed 120 percent of the weighted average economic life of the facilities or projects to be financed, in keeping with Internal Revenue Service regulations for tax-exempt governmental financing obligations, and to assure that long-term debt is not issued to finance projects with a short useful life, unless specific circumstances exist that would mitigate the extension of time to repay the debt and it would not cause the City to violate any covenants to maintain the tax-exempt status of such debt, if applicable.

    b. When project revenues or specific resources will be sufficient to service the long-term debt.

    c. The capital project has been, or will be, included in the City’s capital improvement plan or has otherwise been coordinated with the City’s planning goals and objectives.

2. Debt financing will not be considered appropriate for any recurring purposes, such as current operating and maintenance expenditures. The issuance of short-term instruments, such as revenue, tax or bond anticipation notes, is excluded from this limitation.

3. Capital improvements will be financed primarily through user fees, service charges, assessments, special taxes or developer agreements, when benefits can be specifically attributed to users of the facility. Accordingly, development impact fees should be created and implemented at levels sufficient to ensure that new development pays its fair share of the cost of constructing necessary community facilities.

4. The City will use the following criteria to evaluate pay-as-you-go versus long-term financing in funding capital improvements:

Factors Favoring Pay-As-You-Go Financing

a. Current revenues and adequate fund balances are available or project phasing can be accomplished.

b. Existing debt levels adversely affect the City's credit rating.

c. Market conditions are unstable or present difficulties in marketing.

Factors Favoring Long-Term Financing

a. Revenues available for debt service (based on historical, budgeted, and projected revenues) are deemed sufficient and reliable, so that long-term financings can be marketed with investment grade credit ratings.

b. The project securing the financing is of the type which will support an investment grade credit rating.

c. Market conditions present favorable interest rates and demand for City financings.

d. A project is mandated by state or federal requirements, and resources are insufficient or unavailable.

e. The project is immediately required to meet or relieve capacity needs and current resources are insufficient or unavailable.

f. The life of the project or asset to be financed is 10 years or longer.

VII. Debt Management

1. *Policies Relating to Issuance of Debt*

a. The City will not obligate the General Fund to secure long-term financings, except when marketability can be significantly enhanced.

b. An internal feasibility analysis will be prepared for each long-term financing, which analyzes the impact on current and future budgets for debt service and operations. This analysis will also address the reliability of revenues to support debt service.

c. The City will seek an investment grade rating of Baa/BBB or greater on any direct debt and will seek credit enhancements, such as letters of credit or insurance, when necessary for marketing purposes, availability, and cost-effectiveness.

d. The City will follow a policy of meaningful, not misleading, and transparent disclosure of all "material" information (as contemplated in the federal securities laws and defined in the City's Disclosure Procedures) on every financial report and bond offering document (Official Statement).

2. *Policies Relating to Post-Issuance Debt Management*

   a. The City will diligently monitor its compliance with bond covenants and ensure its adherence to federal arbitrage regulations, in keeping with the covenants of the City and/or related entity in the tax certificate for any federally tax-exempt financing.

   b. The City will maintain good, ongoing communications with bond rating agencies regarding its financial condition. The City will follow a policy of timely and adequate disclosure on every post-issuance financial report filed in connection with the City's contractual continuing disclosure undertakings.

3. *Internal Control Procedures Concerning Use of Proceeds of Debt*

   a. The Administrative Services Director shall retain a copy of each annual report filed with the California Debt and Investment Advisory Commission (CDIAC) pursuant to Section 8855(k) of the California Government Code concerning (1) debt authorized during the applicable reporting period (whether issued or not), (2) debt outstanding during the reporting period, and (3) the use, during the reporting period, of proceeds of issued debt.

      Such records shall be retained while any bonds of an issue are outstanding and during the three-year period following the final maturity or redemption of the bond issue or, if later, while any bonds that refund bonds of that original issue are outstanding and for the three year period following the final maturity or redemption date of the latest refunding bond issue.

   b. In connection with the preparation of each annual report to be filed with CDIAC pursuant to Section 8855(k) of the California Government Code, the Administrative Services Director or the designee of the Administrative Services Director shall keep a record of the original intended use for which the debt has been issued, and indicate whether the proceeds spent during the applicable one-year reporting period for such annual report comply with the intended use (at the time of original issuance or as modified pursuant to the following sentence). If a change in intended use has been authorized subsequent to the original issuance of the debt, the Administrative Services Director or the designee of the Administrative Services Director shall indicate in the record when the change in use was authorized and whether the City Council, City Manager, or another City official has authorized the change in intended use. The Administrative Services Director shall report apparent deviations from the intended use in debt proceeds to the City Manager for further discussion, and if the City Manager determines it appropriate, in consultation with legal counsel (which may be bond counsel, if applicable, or the City Attorney), to the City Council.

   c. If the debt has been issued to finance a capital project and the project timeline or scope of project has changed in a way that all or a portion of the debt proceeds cannot be expended on the original project, the Administrative Services Director shall consult with the City Manager and legal counsel (which may be bond counsel, if applicable, or the City Attorney) as to available alternatives for the expenditure of the remaining debt proceeds (including prepayment of the debt). After such consultation, the Administrative Services Director shall seek the direction of the City Council as to an alternative for the expenditure or use of such remaining debt proceeds.

VIII. Affordability and Planning Policies

The City recognizes that there are numerous types of financing structures and funding sources available, each with specific benefits, risks, and costs. All potential funding sources are reviewed by management, within the context of this Policy and the overall portfolio, to ensure that any financial product or structure is consistent with the City's objectives. Regardless of what financing structure(s) is utilized, due diligence review must be performed for each transaction, including the quantification of potential risks and benefits, and analysis of the impact on City creditworthiness and debt affordability and capacity.

Fixed interest rate debt is typically preferred to maintain a more predictable debt service burden. Variable rate debt sometimes can provide a lower cost of borrowing in the short run, but may involve greater medium-term or long-term risk. Due diligence review must be performed for each transaction, including the quantification of potential risks and benefits, analysis of the impact on City creditworthiness and debt affordability and capacity. If variable rate debt is proposed to be issued, an evaluation shall be undertaken of the ability of the City to withstand the medium-term or long-term risk attendant to variable rate debt, including the management of interest rate risk through derivate products (such as interest rate swaps) and liquidity risk (such as the continued availability of credit support and remarketing instruments), and the feasibility of exit strategies. A derivatives policy will be adopted by the City prior to any utilization of derivative products.

IX. Type of Financing Instruments

1. **General Fund-Supported Debt** – General Fund Supported Debt generally includes Certificates of Participation (COPs) and Lease Revenue Bonds (LRBs), which are lease obligations that are secured by an installment sale or by a lease-back arrangement between the City and another public entity. The general operating revenues of the City are pledged to pay the lease payments, which are, in turn, used to pay debt service on the bonds or Certificates of Participation.

   General Fund Supported Debt may also include bonds issued to refund obligations imposed by law, such as judgments (judgment obligation bonds (JOBs)) or unfunded accrued actuarial liabilities for pension plans (pension obligation bonds (POBs)).

   These obligations do not constitute indebtedness under the state constitutional debt limitation and, therefore, are not subject to voter approval.

Payments to be made under valid leases are payable only in the year in which use and occupancy of the leased property is available, and lease payments may not be accelerated. Lease financing requires the fair market rental value of the leased property to be equal to or greater than the required debt service or lease payment schedule. The lessee (City) is obligated to include in its Annual Budget and appropriate the rental payments that are due and payable during each fiscal year the lessee has use of the leased property.

The City should strive to maintain its net General Fund-backed annual debt service at or less than 10% of available annually budgeted General Fund revenues. This ratio is defined as the City's annual debt service requirements on General Fund Supported Debt (including, but not limited to, COPs, LRBs, JOBs, and POBs) compared to total annual General Fund Revenues, net of interfund transfers.

2. **Enterprise Revenue Bonds** – Long-term obligations payable solely from specific special fund sources, in general, are not subject to a debt limitation. Examples of such long-term obligations include those which are payable from a special fund consisting of restricted revenues or user fees (Enterprise Revenues) and revenues derived from the system of which the project being funded is a part.

   The City will set enterprise fund rates at levels needed to fully cover debt service requirements as well as operations, maintenance, administration and capital improvement costs, and to comply with any applicable coverage ratio requirement set forth in the City's existing financing documents. The ability to afford new debt for enterprise operations will be evaluated as an integral part of the City's rate review and setting process.

3. **Special Districts Financing** – Typical special districts financed with bonds primarily consist of Community Facilities Districts (CFDs) and 1913/1915 Act Assessment Districts (Assessment Districts). The City will consider requests for special district formation and debt issuance when such requests address a public need or provide a public benefit. Each application will be considered on a case by case basis, and the Administrative Services Director may not recommend a financing if it is determined that the financing could be detrimental to the debt position or the best interests of the City.

4. **General Obligation Bonds** – Notwithstanding their name, General Obligation Bonds are not general obligations of the City, but instead, are payable from and secured by a dedicated, voter-approved property tax override rate (*i.e.,* a property tax in excess of the 1% basic *ad valorem* property tax rate which has received the approving two-thirds vote of the City's electorate). While the dedicated revenue stream to repay the debt makes General Obligation Bonds an attractive option, additional considerations for this financing mechanism include the time and expense of an election, the possibility that the electorate will not approve the ballot measure, and the legal bonding capacity limit (for general law cities, 3.75% of the assessed value of all taxable property within the City).

5. **Tax Increment Financing** – Tax Increment Financing is payable from and secured by a portion of *ad valorem* property taxes that are allocated to a successor agency to

redevelopment agency (Successor Agency), an enhanced infrastructure financing district (EIFD), or a community revitalization and investment authority (CRIA) subject to a plan adopted for such entity and the applicable law. While tax increment debt for redevelopment agencies and Successor Agencies is entitled to the benefits of Article XVI, Section 16, of the California Constitution, no similar provision exists for EIFDs and CRIAs at the time of adoption of this Policy. Therefore, when considering EIFD or CRIA financing, debt limit concerns should be analyzed with respect to the proposed structure and taken into account in determining the practical viability of the proposed financing.

6. **Conduit Debt** – Conduit financing provides for the issuance of securities by a government agency to finance a project of a third-party, such as a non-profit organization or other private entity. The City may sponsor conduit financings for those activities that have a general public purpose and are consistent with the City's overall service and policy objectives. Unless a compelling public policy rationale exists, such conduit financings will not, in any way, pledge the City's faith and credit

X. <u>Refinancings</u>

1. General Guidelines. Periodic reviews of all outstanding debt will be undertaken to determine refinancing opportunities. Refinancings will be considered (within federal tax law constraints), under the following conditions:

   a. There is a net economic benefit.

   b. It is needed to modernize covenants that are adversely affecting the City's financial position or operations.

   c. The City desires to reduce the principal outstanding in order to achieve future debt service savings, and it has available working capital to do so from other sources.

   d. The City must refinance a bullet payment or spike in debt service.

DATED: ______________ BY: ________________________________
Oliver Chi
City Manager

APPROVED AS TO FORM: ATTEST:

______________________________ BY: ________________________________
Craig A. Steele
City Attorney

Alice D. Atkins
City Clerk