

City of Brisbane

Agenda Report

To: City Council via City Manager

From: Stuart Schillinger, Administrative Services Director

Subject: Updating the City's Debt Policy

Date: July 20, 2017

Purpose:

To ensure the City issues debt in a responsible and thoughtful fashion which is compliant with current State law. Debt should be used as part of long-term strategy to match capital projects expected life with its financing or to reduce the current costs of the City allowing for more flexibility in City decision making.

Recommendation:

Adopt the revised Debt Policy with any changes City Council decides is necessary.

Background:

The City's Financial Advisor (Marty Johnson) reviewed the City's policies to ensure consistency with current State Law. On September 12, 2016 the Governor approved SB 1209. This law provided additional guidance and requirements for what needs to be included in a city's debt policy. The City's current policy speaks to the policy level considerations for the use of debt while the law requires more detail information.

Discussion:

Attached for your review is the policy drafted by our Financial Advisor and reviewed by staff to ensure compliance with State Law and the goals of the City.

Page 2 of the policy states the purpose for debt and when the City would use long-term debt. Debt would be used for capital projects where the life of the asset equals or exceeds the term of the bond issue. An instance of this was matching the anticipated life of the Marina Dredging Project with the length of the bond issue. Another purpose of issuing long-term debt is when refinancing a previously outstanding debt issue can save the City money. For example the current refunding the City is executing for the 2009A bonds which saves the City approximately \$30,000 a year. Additionally, all debt that is issued will have an identifiable repayment source. It could be from user fees as in the case of Utility Bonds or Marina Bonds, or General Fund resources as was the case for the City Hall financing issues.

Page 3 discusses the use of Short-Term debt. The main use of this style of debt is for leasing equipment like copiers. However, in the future it could also be for vehicles or other short lived assets if interest rates make it more favorable for leasing instead of purchasing.

Page 4 discusses Financing on Behalf of Other Entities. The City would do this to further a public purpose. In the case of the Northeast Ridge Financing it was to pay for storm drains and other public improvements. The City will only issue this type of debt when there is an outside repayment source and the City will in no event incur any liability or assume responsibility for payment of debt service for such debt.

Pages 5 and 6 discuss the various types of debt the City could issue. The City has not issued either Multi-Family Mortgage Revenue Bonds or HUD Section 108 Loan Guarantee Program debt in the past nor does staff foresee the City issuing this type of debt in the near future. However, it seemed prudent to include both of these in case the circumstances or needs of the City changed.

Page 7 discusses the three methods of sale the City can use for issuing debt.

Page 8 explains the relationship of debt to the capital improvement program and the budget as well as restating the City's policy goals.

Page 9 states the internal control procedures and when the debt policy can be waived.

Fiscal Impact:

There is no fiscal impact to the City for adopting the policy but it is a best practice to have this policy in place and it will meet the requirements of the State Law.

Measure of Success

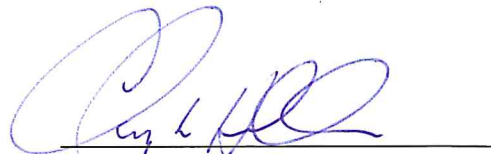
The City maintains a strong financial position by the prudent issuance of debt.

Attachments:

Existing Capital Financing and Debt Management Policy
New Debt Management Policy



Stuart Schillinger
Administrative Services Director



Clay Holstine
City Manager

Capital Financing and Debt Management

Capital Financing

- A. The City will consider the use of debt financing only for one-time capital improvement projects and only under the most conservative risk exposure, under the following circumstances:
1. When the project's useful life will exceed the term of the financing.
 2. When project revenues or specific resources will be sufficient to service the long-term debt.
- B. Debt financing will not be considered appropriate for any reoccurring purpose such as current operating and maintenance expenditures.
- C. Capital improvement 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.
- D. The City will use the following criteria to evaluate pay-as-you-go versus long-term financing in funding capital improvements:

Factors which favor pay-as-you-go financing:

1. Current revenues and adequate fund balances are available or project phasing can be accomplished.
2. Existing debt levels adversely affect the City's credit rating.
3. Market conditions are unstable or present difficulties in marketing.

Factors which favor long-term financing:

1. Revenues available for debt service are deemed to be sufficient and reliable so that long-term financings can be marketed with investment grade credit ratings.
2. The project securing the financing is of the type, which will support an investment grade credit rating.
3. Market conditions present favorable interest rates and demand for City financings.
4. A project is mandated by state or federal requirements, and resources are insufficient or unavailable.
5. The project is immediately required to meet or relieve capacity needs and current resources are insufficient or unavailable.
6. The life of the project or asset to be financed is 10 years or longer.

Debt Management

- A. The City will not obligate the General Fund to secure long-term financings except when marketability can be significantly enhanced.
- B. No more than 60% of capital improvement outlays will be funded from long-term financings; and direct debt will not exceed 2% of net assessed valuation.
- C. 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.
- D. The City will generally conduct financings on a competitive basis. However, negotiated financings may be used due to market volatility or the use of an unusual or complex financing or security structure.
- E. The City will seek an investment grade rating (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, or cost-effectiveness.
- F. The City will monitor all forms of debt annually coincident with the City's Financial Plan preparation and review process and report concerns and remedies, if needed, to the Council.
- G. The City will diligently monitor its compliance with bond covenants and ensure its adherence to federal arbitrage regulations and continuing disclosure requirements.
- H. The City will maintain good communications with bond rating agencies about its financial condition. The City will follow a policy of full disclosure on every financial report and bond prospectus (Official Statement).

Conduit Financings

Conduit financings are defined as a financing in which the proceeds of the issue are loaned to a nongovernmental borrower who then applies the proceeds for a project financing or (if permitted by federal tax law for a qualified 501 (C) (3) bond) for working capital purposes. Typically, the project financed is owned and operated by the borrower, but projects may also be financed for lease to the private user or for sale pursuant to an installment sales contract. Statutes authorizing conduit financings generally specify the nature of the projects, which may be financed, and limit such projects to those with a specified public purpose.

- A. The City will consider requests for conduit financing on a case-by-case basis using the following criteria:

Current Policy

1. The City's bond counsel will review the terms of the financing, and render an opinion that there will be no liability to the City in issuing the bonds on behalf of the applicant.
 2. There is a clearly articulated public purpose in providing the conduit financing.
 3. The applicant is capable of achieving this public purpose.
 4. The applicant is able to demonstrate a high likelihood of successfully completing the project being financed.
- B. This means that the review of request for conduit financing will generally be a two-step process: first, asking the Council if they are interested in considering the request and establishing the ground rules for evaluating it; and then, returning with the results of this evaluation, and recommending approval of appropriate financing documents if warranted. This two-step approach ensures that the issues are clear for both the City and applicant and that key policy questions are answered.

City of Brisbane, California

Debt Management Policy



Prepared June 2017

JNA Consulting Group, LLC

410 Nevada Way, Suite 200

Boulder City, NV 89006

702-294-5100 fax 702-294-5145



EXECUTIVE SUMMARY

This Debt Management Policy (the “Debt Policy”) has been developed to provide guidance in the issuance and management of debt by the City of Brisbane (the “City” or “Brisbane”) or any other public agency for which the City Council sits as its legislative body and is intended to comply with Government Code Section 8855(I), effective on January 1, 2017. The main objectives are to establish conditions for the use of debt; to ensure that debt capacity and affordability are adequately considered; to minimize the City’s interest and issuance costs; to maintain the highest possible credit rating; to provide complete financial disclosure and reporting; and to maintain financial flexibility for the City.

Debt, properly issued and managed, is a critical element in any financial management program. It assists in the City’s effort to allocate limited resources to provide the highest quality of service and facilities to the public. The City desires to manage its debt program to promote economic growth and enhance the vitality of the City for its residents and businesses.

This Debt Policy was approved by the City Council on July 20, 2017. The Debt Policy may be amended by the City Council as it deems appropriate from time to time in the prudent management of the debt of the City.

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FINDINGS

This Debt Policy shall govern all debt undertaken by the City. The City hereby recognizes that a fiscally prudent debt policy is required in order to:

- Maintain the City's sound financial position.
- Ensure the City has the flexibility to respond to changes in future capital needs and service priorities, revenue levels, and operating expenses.
- Protect the City's credit-worthiness.
- Ensure that all debt repayment is structured to protect both current and future taxpayers, ratepayers and constituents of the City and fit within the projected revenues available to pay debt service.
- Ensure that the City's use and repayment of debt is consistent with the City's planning goals and objectives and capital improvement program or budget, as applicable.
- Encourage those that benefit from a proposed facility or improvement to pay the cost of that facility or improvement to minimize the impact on limited general fund resources.

POLICIES

Purposes For Which Debt May Be Issued

The City will consider the use of debt financing primarily for capital improvement projects (CIP) when the project's useful life will equal or exceed the term of the financing and when resources are identified sufficient to fund the debt service requirements. An exception to this CIP driven focus is the issuance of short-term instruments such as tax and revenue anticipation notes, which are to be used for prudent cash management purposes and conduit financing, as described below. Bonded debt should not be issued for projects with minimal public benefit or support, or to finance normal operating expenses.

If a department has any project which is expected to use debt financing, the department director is responsible for providing the City Manager and the Administrative Services Director with reasonable cost estimates, including identifying sources for the payment for debt service. This will allow for an analysis of the project's potential impact on the City's debt capacity and limitations. The department director shall also provide an estimate of any incremental operating and/or additional maintenance costs associated with the project and identify sources of revenue, if any, to pay for such incremental costs.

Long-Term Debt

Long-term debt may be issued to finance or refinance the construction, acquisition, and rehabilitation of capital improvements and facilities, equipment and land to be owned and/or operated by the City. Long-term debt financings are appropriate when the following conditions exist:

- When the project to be financed is necessary to provide basic services.
- When the project to be financed will provide benefit to constituents over multiple years.
- When total debt does not constitute an unreasonable burden to the City and its taxpayers and ratepayers.
- When the debt is used to refinance outstanding debt in order to produce debt service savings or to realize the benefits of a debt restructuring.
- Long-term debt financings will not generally be considered appropriate for current operating expenses and routine maintenance expenses.

The City may use long-term debt financings subject to the following conditions:

- The project to be financed has been or will be approved by the City Council.
- The weighted average maturity of the debt (or the portion of the debt allocated to the project) will not exceed the average useful life of the project to be financed by more than 20%, unless specific conditions 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.
- The City estimates that sufficient income or revenues will be available to service the debt through its maturity.
- The City determines that the issuance of the debt will comply with the applicable requirements of state and federal law.
- The City considers the improvement/facility to be of vital, time-sensitive need of the community and there are no plausible alternative financing sources
- Periodic reviews of outstanding long-term debt will be undertaken to identify refunding opportunities. Refunding will be considered (within federal tax law constraints, if applicable) if and when there is a net economic benefit of the refunding. Refundings which are non-economic may be undertaken to achieve City objectives relating to changes in covenants, call provisions, operational flexibility, tax status of the issuer, or the debt service profile.

In general, refundings which produce a net present value savings of at least three percent (3%) of the refunded par amount will be considered economically viable. Refundings which produce a net present value savings of less than three percent (3%) will be considered on a case-by-case basis, and are subject to City Council approval. Advance refundings will also be evaluated based on the future outlook for interest rates, breakeven analysis and the potential use of the estimated debt service savings.

Short-term Debt Short-term borrowing may be issued to generate funding for cash flow needs in the form of Tax and Revenue Anticipation Notes (TRAN).

Short-term borrowing, such as commercial paper, and lines of credit, will be considered as an interim source of funding in anticipation of long-term borrowing. Short-term debt may be issued for any purpose for which long-term debt may be issued, including capitalized interest and other financing-related costs. Prior to issuance of the short-term debt, a reliable revenue source shall be identified to secure repayment of the debt. The final maturity of the debt issued to finance the project shall be consistent with the economic or useful life of the project and, unless the City Council determines that extraordinary circumstances exist, must not exceed seven (7) years.

Short-term debt may also be used to finance short-lived capital projects; for example, the City may undertake lease-purchase financing for equipment, and such equipment leases may be longer than 7 years.

Financings on Behalf of Other Entities

The City may also find it beneficial to issue debt on behalf of other governmental agencies or private third parties in order to further the public purposes of City. In such cases, the City shall take reasonable steps to confirm the financial feasibility of the project to be financed and the financial solvency of any borrower and that the issuance of such debt is consistent with the policies set forth herein. In no event will the City incur any liability or assume responsibility for payment of debt service on such debt.

TYPES OF DEBT

In order to maximize the financial options available to benefit the public, it is the policy of the City of Brisbane to allow for the consideration of issuing all generally accepted types of debt, including, but not exclusive to the following:

General Obligation (GO) Bonds

General Obligation Bonds are suitable for use in the construction or acquisition of improvements to real property that benefit the public at large. Examples of projects include libraries, parks, and public safety facilities. All GO bonds shall be authorized by the requisite number of voters in order to pass.

Revenue Bonds

Revenue Bonds are limited-liability obligations tied to a specific enterprise or special fund revenue stream where the projects financed clearly benefit or relate to the enterprise or are otherwise permissible uses of the special revenue. An example of projects that would be financed by a Revenue Bond would be improvements to a utility system, which would be paid back with money raised from the rates and charges to water users. Generally, no voter approval is required to issue this type of obligation but in some cases, the City must comply with proposition 218 regarding rate adjustments.

Lease-Backed Debt/Certificates of Participation (COP/Lease Revenue Bonds)

Issuance of Lease-backed debt is a commonly used form of debt that allows a City to finance projects where the debt service is secured via a lease agreement and where the payments are budgeted in the annual budget appropriation by the City from the general fund. Lease-Backed debt does not constitute indebtedness under the state or the City's constitutional debt limit and does not require voter approval. Lease Revenue Bonds may be issued by the Brisbane/Guadalupe Valley Municipal Improvement District Public Financing Authority on behalf of the City.

Special Assessment/Special Tax District Debt

The City will consider requests from developers for the use of debt financing secured by property based assessments or special taxes in order to provide for necessary infrastructure for new development only under strict guidelines adopted by the City Council, which may include minimum value-to-lien ratios and maximum tax burdens. Examples of this type of debt are Assessment Districts (AD) and Community Facilities Districts (CFD) sometimes referred to as Mello-Roos Districts. In order to protect bondholders as well as the City's credit rating, the City will also comply with all State guidelines regarding the issuance of special tax district or special assessment debt, as well as any policy required to be adopted under Government Code Section 53312.7.

Tax Allocation Bonds

Tax Allocation Bonds are special obligations that are secured by the allocation of tax increment revenues that are generated by increased property taxes in the designated redevelopment area. Tax Allocation Bonds are not debt of the City. Due to changes in the law affecting California Redevelopment agencies with the passage of ABX1 26 (as amended, the Dissolution Act) as codified in the California Health and Safety Code, the Brisbane Redevelopment Agency (RDA) was dissolved as of

[February 1, 2012], and its operations substantially eliminated but for the continuation of certain enforceable RDA obligations to be administered by the Successor Agency. The Successor Agency may issue Tax Allocation Bonds to refinance outstanding obligations of the RDA, subject to limitations included in the Dissolution Act.

Multi-Family Mortgage Revenue Bonds

The City is authorized to issue mortgage revenue bonds to finance the development, acquisition and rehabilitation of multi-family rental projects. The interest on the bonds can be exempt from Federal and State taxation. As a result, bonds provide below market financing for qualified rental projects. In addition, the bonds issued can qualify projects for allocations of Federal low-income housing tax credits, which can provide a significant portion of the funding necessary to develop affordable housing.

HUD Section 108 Loan Guarantee Program

The U.S. Department of Housing and Urban Development (HUD) Section 108 Loan Guarantee Program allows cities to use their annual Community Development Block Grant (CDBG) entitlement grants to obtain federally guaranteed funds large enough to stimulate or pay for major community development and economic development projects. The program does not require a pledge of the City's General Fund, only of future CDBG entitlements. By pledging future CDBG entitlement grants as security, the City can borrow at favorable interest rates because of HUD's guarantee of repayment to investors.

The City may from time to time find that other forms of debt would be beneficial to further its public purposes and may approve such debt without an amendment of this Debt Policy.

To maintain a predictable debt service burden, the City will give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is variable rate debt. The City may choose to issue securities that pay a rate of interest that adjusts after a pre-determined period according to a pre-determined formula or a rate resulting from a periodic remarketing of securities. When making the determination to issue bonds with a variable rate, consideration will be given in regards to the useful life of the project or facility being financed or the term of the project requiring the funding, market conditions, credit risk and third party risk analysis, and the overall debt portfolio structure when issuing variable rate debt for any purpose. The maximum amount of variable-rate debt should be limited to no more than 20 percent of the total debt portfolio.

The City will not employ derivatives, such as interest rate swaps, in its debt program. A derivative product is a financial instrument which derives its own value from the value of another instrument, usually an underlying asset such as a stock, bond, or an underlying reference such as an interest rate. Derivatives are commonly used as hedging devices in managing interest rate risk and thereby reducing borrowing costs. However, these products bear certain risks not associated with standard debt instruments.

METHOD OF SALE

Bonds can generally be sold at a competitive sale or negotiated sale, or be privately placed.

Competitive Sale

Offering documents are sent to any firm interested in purchasing the bonds. A day and time are chosen for the sale and bonds are awarded to the firm offering the lowest true interest cost on the bonds (the "TIC"). The TIC is the discount rate which results in a present value of the future debt service payments equal to amount bid for the bonds.

Negotiated Sale

One firm, or group of firms, is chosen in advance to offer the bonds for sale. At the time of sale, interest rates and other terms of the bonds are negotiated with the Underwriter.

Direct Placement

A purchaser, usually an individual or bank, is identified and the bonds are placed directly. The purchaser can be selected through either a competitive or negotiated process. Interest rates and other terms of the bonds are negotiated with the selected purchaser.

The City will generally pursue a competitive sale. There are certain circumstances under which the City would consider a negotiated sale or private placements. Such circumstances include, but are not limited to;

- Bonds issued with a variable rate of interest
- Bonds rated below A- or not rated
- Very small or very large bond issues
- Unstable or highly volatile markets
- Bonds with unusual security or structure
- Bonds for which a negotiated sale provides other benefits such as flexible timing or local marketing of bonds

If the City determines that a negotiated sale is warranted it will select an underwriting firm(s) based on a competitive process and/or prior performance. The selection of an underwriter(s) will be based on a determination of the firm that demonstrates its ability to obtain the overall best interest rate for City while achieving the City's goals with the financing. Consideration in making this determination will be given to the firm's experience with similar financings, proposed compensation structure and marketing plan.

RELATIONSHIP OF DEBT TO CAPITAL IMPROVEMENT PROGRAM AND BUDGET

The City intends to issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the City's capital budget and the capital improvement plan.

The City shall strive to fund the upkeep and maintenance of its infrastructure and facilities due to normal wear and tear through the expenditure of available operating revenues. The City shall seek to avoid the use of debt to fund infrastructure and facilities improvements that are the result of normal wear and tear, unless a specific revenue source has been identified for this purpose.

The City shall integrate its debt issuances with the goals of its capital improvement program by timing the issuance of debt to ensure that bond proceeds are available when needed in furtherance of the City's public purposes.

The City shall seek to issue debt in a timely manner to avoid having to make unplanned expenditures for capital improvements or equipment from its general fund or holding bond proceeds for extended periods while earning negative arbitrage.

POLICY GOALS RELATED TO PLANNING GOALS AND OBJECTIVES

The City is committed to financial planning, maintaining appropriate reserves levels and employing prudent practices in governance, management and budget administration. The City intends to issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the City's annual operating budget.

It is a policy goal of the City to protect taxpayers, ratepayers and constituents by utilizing conservative financing methods and techniques so as to obtain the highest practical credit ratings (if applicable) and the lowest practical borrowing costs.

The City will comply with applicable state and federal law as it pertains to the maximum term of debt and the procedures for levying and imposing any related taxes, assessments, rates and charges.

When refinancing debt, it shall be the policy goal of the City to realize, whenever possible, and subject to any overriding non-financial policy considerations minimum net present value debt service savings equal to or greater than 3% of the refunded principal amount. This is described in the section on long-term debt.

INTERNAL CONTROL PROCEDURES

When issuing debt, in addition to complying with the terms of this Debt Policy, the City shall comply with any other applicable policies regarding initial bond disclosure, continuing disclosure, post-issuance compliance, and investment of bond proceeds.

The City will periodically review the requirements of and will remain in compliance with the following:

- any continuing disclosure undertakings under SEC Rule 15c2-12,
- any federal tax compliance requirements, including without limitation arbitrage and rebate compliance, related to any prior bond issues, and
- the City's investment policies as they relate to the investment of bond proceeds.

Whenever reasonably possible, proceeds of debt will be held by a third-party trustee and the City will submit written requisitions for such proceeds. The City will submit a requisition only after obtaining the signature of the City Manager or the Administrative Services Director or a designee.

WAIVERS OF DEBT POLICY

There may be circumstances from time to time when strict adherence to a provision of this Debt Policy is not possible or in the best interests of the City and the failure of a debt financing to comply with one or more provisions of this Debt Policy shall in no way affect the validity of any debt issued by the City in accordance with applicable laws.