City of South Bend Administration & Finance Policy Manual

2.17 Debt Management Policy *Effective: May 5, 2014*

Purpose: This policy defines the debt management policy of the City of South Bend.

Scope: This statement applies to all governmental units, enterprise operations, and operations of the City of South Bend.

Responsibility: This policy is the responsibility of the Controller of the City of South Bend. Changes or revisions to this policy are affected only with the consent and approval of the Controller.

Effective Date: This policy is effective May 5, 2014.

1.0 Policy Statement

The following debt management policy should be used to provide the general framework for planning and reviewing debt proposals. City Administration recognizes there are no absolute rules or easy formulas that can substitute for a thorough review of all information affecting the City's debt position. Debt decisions should be the result of deliberative consideration of all factors involved.

1.1 Debt will be used to finance long-lived capital and operating assets within the constraints of maintaining or improving bond ratings and debt service capacity.

1.2 Debt management will provide for the protection of bond ratings, the maintenance of adequate debt service reserves, compliance with debt instruments provisions and appropriate disclosures to investors, underwriters, and rating agencies.

1.3 Investment management will strive to maximize investment return on the City's funds through pooling of funds where permitted, frequent market analysis, cash forecasting procedures and competitive bidding. Interest income is applied on a percentage basis to each fund based on each fund's balance compared to all total fund balances.

1.4 The City shall seek to maintain and, if possible, to improve its current bond rating so borrowing costs are minimized and access to credit is preserved. It is imperative that the City demonstrates to rating agencies, investment bankers, creditors, and taxpayers that City officials are following a prescribed financial plan. The City will follow a policy of full disclosure by communicating with bond rating agencies to inform them of the City's financial condition.

1.5 Every future bond issue proposal will be accompanied by an analysis, demonstrating conformity to the debt policies adopted by the Mayor. The City Controller will review and comment on each bond issue proposal regarding conformance with existing debt and financial policies, and specific aspects of the proposed financing package and its impact on the City's creditworthiness.

1.6 The City recognizes that it is of the utmost importance that elected and appointed City officials, and all others associated with the issuance of City debt, not only avoid the reality of a conflict of interest, but the appearance thereof as well. City officials must conduct themselves in a manner consistent with the best interest of the City and taxpayers. Elected and appointed City officials should avoid even the appearance of linkages between politics and public finance that can erode the confidence of taxpayers, ratepayers, and voters. This includes avoiding gratuities, and political contributions of more than nominal value from service providers and the disclosure of all possible conflicts of interest shall be provided in writing and filed with Corporation Counsel.

1.7 Bonds will be sold on a competitive basis unless it is in the best interest of the City of conduct a negotiated sale. Competitive sales will be the preferred method. Negotiated sales may occur when selling bonds for a defeasance of existing debt, for current or advanced refunding of debt, or for other appropriate reasons.

2.0 Taxpayer Equity

2.1 South Bend's property taxpayers and residents who benefit from projects financed by bonds should be the source of the related debt service funding. This principle of taxpayer equity should be a primary consideration in determining the type of projects selected for financing through bonds. Furthermore, the principle of taxpayer equity shall be applied for setting rates in determining net revenues for bond coverage ratios.

3.0 Uses

3.1 Bond proceeds should be limited to financing the costs of planning, design, land acquisition, buildings, permanent structures, attached fixtures or equipment, and movable pieces of equipment, such as fire engines, or other costs as permitted by law. Utility revenue bond proceeds may be used to establish a debt service reserve as allowed by State law. Acceptable uses of bond proceeds can be viewed as items, which can be capitalized. Non-capital furnishings and supplies will not be financed from bond proceeds. Refunding bond issues designed to restructure currently outstanding debt are acceptable use of bond proceeds.

3.2 The City will not use short-term borrowing to finance operating needs except in the case of an extreme financial emergency, which is beyond its control or reasonable ability to forecast. Recognizing that bond issuance costs add to the total interest costs of financing, the City shall perform due diligence to ensure that installment agreement or other legally appropriate debt is considered whenever applicable.

4.0 Decision Analysis

4.1 Whenever the City is contemplating a possible bond issue, information will be developed concerning the following four categories commonly used by rating agencies assessing the City's creditworthiness. The subcategories are representative of the types of items to be considered. The City Controller will present this information to the Mayor for his/her review, as needed.

4.1.a <u>Debt Analysis</u>

- Debt capacity analysis
- Purpose for which debt is issued
- Debt structure
- Debt burden
- Debt history and trends
- Adequacy of debt and capital planning
- Obsolescent of capital plant

4.1.b Financial Analysis

- Stability, diversity, and growth rates of tax or other revenue sources
- Trend in assessed valuation and collections
- Current budget trends
- Appraisal of past revenue and expenditure trends
- History and long-term trends of revenues and expenditures
- Evidences of financial planning
- Adherence to generally accepted accounting principles
- Audit results
- Fund balance status and trends in operating and debt funds
- Financial monitoring systems and capabilities
- Cash flow projections

4.1.c Governmental and Administrative Analysis

- Government organization structure
- Location of financial responsibilities and degree of control
- Adequacy of basic service provision
- Intergovernmental cooperation/conflict and extent of duplication
- Overall city planning efforts

4.1.d Economic Analysis

- Geographic and location advantages
- Population and demographic characteristics
- Wealth indicators
- Housing characteristics
- Level of new construction
- Types of employment, industry, and occupation
- Evidences of industrial decline
- Trend of the economy

4.2 The City may use the services of qualified internal staff and outside advisors to assist in the analysis, evaluation, and decision process, including bond counsel and financial advisors. Recognizing the importance and value to the City's creditworthiness and marketability of the City’s bonds, this policy is intended to ensure that potential debt complies with all laws and regulations, as well as sound financial principles.

5.0 General Obligation Bonds

5.1 Every project proposed for financing through general obligation debt should be accompanied by a full analysis of the future operating and maintenance costs associated with the project.

5.2 Generally, bonds cannot be issued for a longer maturity schedule than a conservative estimate of the useful life of the asset to be financed. The City will attempt to keep the average maturity of new general obligation bonds at or below 20 years. The City will limit the total of its general obligation debt to a level consistent with Indiana law.

5.3 Whenever possible, the City will finance capital projects by using self-supporting revenue bonds. Revenue bonds assure the greatest degree of equity because those who benefit from a project and those who pay for a project are most closely matched.

6.0 Limited Tax General Obligation Debt

6.1 Limited tax general obligation bonds should be considered when constraints preclude the use of general obligation bonds. As a precondition to the issuance of limited tax general obligation bonds, all alternative methods of financing should have been investigated. Consideration should always be given to provide a pledge of facility revenue to accompany the basic pledge of limited tax revenues.

6.2 Limited tax general obligation bonds should be issued under certain conditions:

6.2.a A project to be financed will generate positive net revenues, i.e. additional revenues generated by the project will be greater than the debt service requirements. The net revenues should be positive over the life of the bonds, and be positive each year, if possible. The City recognizes that net revenues may not be positive in the early years of certain projects, but should be positive within a reasonable time period of five to seven years. These calculations will be made on a conservative basis so that the potential for a long-term net decrease in general fund revenues is minimized.

6.2.b Matching fund monies are available which may be lost if not applied for in a timely manner.

6.2.c Catastrophic conditions.

6.2.d A project may be financed when the analysis shows the impact to the organization is in the best interest of the City for the long-term.

7.0 Revenue Bonded Debt

7.1 It will be a long-term goal that each utility or enterprise will ensure future capital financing needs are met by using a combination of current operating revenues and revenue bond financing. Therefore, a goal is established that 15% of total project costs should come from operating funds of the utility or enterprise, if feasible.

7.2 It is City policy that each utility or enterprise should provide adequate debt service coverage. A specific factor is established that projected operating revenues in excess of operating expenses less capital expenditures, depreciation and amortization in the operating fund should be at least 1.25 times the annual debt service costs.

8.0 Short-Term Financing/Capital Lease Debt

8.1 Short-term financing or capital lease debt will be considered to finance certain equipment and rolling stock purchases when the aggregate cost of equipment to be purchased exceeds $25,000. Adequate funds for the repayment of principal and interest must be included in the requesting service area's approved budget.

8.2 The term of short-term financing will be limited to the usual useful life period of the vehicle or equipment, but in no case will exceed ten years. It is anticipated that most capital lease debt will be for five years.

8.3 Departments requesting capital financing must have an approved budget appropriation. Service areas shall submit documentation for approved purchases to the City Controller's office each year within 60 days after the annual budget is adopted. The City Controller's office will consolidate all requests and may solicit competitive or negotiated proposals for capital financing to ensure the lowest possible interest costs.

9.0 Defeasance of Bonds (Refunding)

9.1 The City will solicit the advice of bond counsel and financial advisor in order to outline key legal and financial issues. Three key criteria will be evaluated when considering a refunding candidate:

- Financial and Policy Objectives
- Financial Savings/Results
- Bond Structure and Escrow Efficiency

9.2 Financial and Policy Objectives – The City will ensure that refunding bond issues comply with the Debt Management Policy objectives set forth herein, and otherwise comply with other City policies.

9.3 Financial Savings – The City shall ensure that refunding results in a positive Net Present Value savings of at least 3%, or $100,000. In certain circumstances, lower savings thresholds may be justified. For example, when an advance refunding is being conducted primarily for policy reasons (other than economic savings), interest rates are at historically low levels or the time remaining to maturity is limited, and as such, future opportunities to achieve greater savings are not likely to occur. In this analysis, the following must be considered:

- Issuance costs and the interest rate at which the bonds can be issued
- The maturity date of the refunded bonds
- Call date of the refunded bonds
- Call premium on the refunded bonds
- Structure and yield of the refunding escrow
- Any transferred proceeds penalty

9.4 Bond Structure and Escrow Efficiency – The City shall pay careful attention to the structure of bonds prior to issuance to address features that may affect flexibility in the future. Potential for refunding shall be anticipated.

9.5 Escrows for defeasance shall be structured to optimize efficiency and savings. All legally eligible securities shall be evaluated with regard to liquidity, risk and yield. Escrow securities shall be selected to mature and/or pay interest as closely as possible prior to debt service requirements of the refunded escrow, and also to minimize risk. The City shall seek the lowest cost escrow agent qualified to manage its escrows.

10.0 Inter-fund Loans

10.1 The City will consider loans to individual funds from the pool of invested funds as an alternative to installment loans and/or bond issuance when conditions warrant. There are situations where such loans are both prudent and appropriate, and can result in cost savings for the City.

10.2 All inter-fund loans will be in compliance with Indiana law and will be approved by the Mayor and City of South Bend Common Council or City of South Bend Redevelopment Commission. Inter-fund amortization schedules will be established to ensure repayment. Inter-fund loans will be in compliance with regulations established by the Indiana State Board of Accounts.