



CDIAC

CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION

# PRINCIPLES AND PRACTICES OF DEBT MANAGEMENT: EMPLOYING A DEBT POLICY

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# **GFOA's Best Practice: Debt Management Policy**

**Susan Gaffney  
SG & Associates**

# Background

- Debt Management Policy First Approved in 1990s to Help Governments Develop an All Encompassing Layout for their Debt Management Program
- Revised (most recently in 2012) to Reflect Changing Market and Practices
- Other GFOA DEBT Best Practices Stem from This Practice
- [http://gfoa.org/sites/default/files/DEBT\\_DEBT\\_MANAGEMENT\\_POLICY.pdf](http://gfoa.org/sites/default/files/DEBT_DEBT_MANAGEMENT_POLICY.pdf)

# Importance of a Debt Policy

- Enhances Internal Management Practices
- External Recognition and Transparency
  - Credit Rating Agencies
  - Outside Professionals/Public Know Entity's Parameters
- IRS Asking for Policies and Procedures
  - Investment of Bond Proceeds
  - Use of Proceeds
- SEC Encouraging Use of Disclosure Policies and Procedures
  - More Aggressive Stance Over Past Few Years
  - MCDC Initiative
- Evolving Federal Regulatory Landscape
  - MA Rule
  - IRS/Issue Price Regulations

# Basics of a Debt Policy

- Authority to Issue Debt – Who Are You?
- When Debt May be Used to Finance Capital Projects
  - Including Use of P3s and TIFs
- Entity's Debt Limits/Debt Capacity
- Types of Debt Allowed to Be Issued
  - General Obligation
  - Revenue
  - Taxable (including tax-credit, subsidy)
  - Fixed or Variable Rate
  - Other Products: POB, OPEB, Derivatives, Notes and Loans
  - Refundings (current and advanced)

# Basics of a Debt Policy

- Structuring Debt
- Hiring, Scope of Services, and Fee Structures for Outside Professionals
- Method of Sale
- Bond Ratings and Enhancements
- Pricing Evaluation
- Investment of Bond Proceeds
- Compliance with Federal Tax & Securities Laws
  - Disclosure, Including Posting Information on EMMA
  - Arbitrage

# Implementing the Policy

- Development by Team (with a leader!)
- Internal/Staff Sign Off
- Approval From Governing Body
- Disseminating to Team (internal and external)
- Compliance Procedures
  - Are We Doing What We Said We'd Do?
  - Developing Checklists to Ensure Compliance
- Schedule to Review and if Needed, Revise

# Other Observations

- Look at Peer Entities
- Develop Section by Section
- Know Which Issues are More Static and Others That Are More Dynamic, and Don't be Afraid to Revise
- Stay Alert for Changing State and Federal Laws and Regulations
- Help Those That Come After You!
  - Professional Staff
  - Elected Officials



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# **EMPLOYING A DEBT MANAGEMENT POLICY PRACTICES AMONG LOCAL AGENCIES**

**Robert Berry, Deputy Executive Director, CDIAC**

# Study Setting

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- State of Municipal Finance
  - Unprecedented fiscal stress among CA agencies
  - Municipal bankruptcies with debt service cited as a root cause
  - Strengthening regulatory environment with penalties applied to issuers
  - Evidence of issuers taking on structures w/o full consideration of all risks or implications

# Study Premise

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- A debt management policy is an essential element of a local agency's debt program
  - ▣ Wealth of debt management policy guidance from GFOA – a comprehensive framework is available
  - ▣ Rating agency consideration when seeking a rating
  - ▣ Risk of non-compliance with MSRB disclosure requirements, IRS
  - ▣ Issuing debt at the lowest cost to rate and taxpayers in the era of enhanced transparency and accountability
- How prepared are California municipal issuers?

# Study Methods

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- Random Sampling
  - ▣ Counties, Cities, and School District Issuers
  - ▣ Debt Issuance(s) occurred 2003 through 2012

Issuer Type	Issuers in Population	Population Volume (Billion)	Issuer Sample Size	Sample Volume (Billion)
Counties	50	\$39	33	\$34
Cities	310	\$47	73	\$28
School Districts	<u>666</u>	<u>\$87</u>	<u>124</u>	<u>\$34</u>
Total	1,026	\$172	230	\$96

- Statistical Note: Sample size provides a +/-10% interval at 95% confidence for each issuer type.

# Study Methods

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- Data Collection
  - ▣ Gathered documents from websites unmistakably identified as Debt Management Policies
  - ▣ If no policy on-line, contacted the agency directly
  - ▣ Counted the document and gathered it for analysis if the agency identified it as a *Debt Management Policy*

Issuer Type	Issuer Sample	Issuers with Policies	Issuers with Policies	Volume (Billion)
Counties	33	20	61%	\$31
Cities	73	36	49%	\$26
School Districts	124	28	23%	\$24

# Study Methods

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- Content Evaluation
  - ▣ GFOA Best Practice Categories/Elements
    - 30 Policy Elements – Each policy scored 1 to 30
    - No weight given to any one policy element
    - Scoring based on the presence of an element, not how well it was addressed
  - ▣ Scoring Teams
    - 2 teams of 2 reviewers
    - Each team reviewed 42 policies with equal number of each agency type
    - Each reviewer scored blindly
    - Conflicts between reviewers/teams were reconciled through joint review and consensus
    - Non-reviewer staff member reviewed all scores for irregularities

# Results: At a Glance

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- Some very strong, comprehensive policies
- As a group, adherence to GFOA standard was poor

Policy Elements	Counties		Cities		School Districts	
	# of Policies	% of Group Total	# of Policies	% of Group Total	# of Policies	% of Group Total
15 or more	11	55	8	22	1	4
Less than 15	<u>9</u>	45	<u>28</u>	78	<u>27</u>	96
Total	20		36		28	
Median	15		7		3	

- Statistical Note: This results apply only to the policies reviewed and can't be projected upon the population of counties, cities, and school districts with debt management policies.

# Results: Debt Limits Category

		DEBT MANAGEMENT POLICY ELEMENTS	PERCENTAGE ADDRESSING ELEMENT		
			COUNTIES	CITIES	SCHOOL DISTRICTS
DEBT LIMITS	PURPOSE OF ISSUE	Restrictions and Uses	95	81	79
		Sources of Repayment	70	50	14
		Useful Life, Matching Asset Life	80	86	32
		PayGo, Integration with Capital Plan	70	53	4
	DEBT LIMITS	Legal/Statutory Limits	75	31	50
		Fiscal Conditions, Ratios	70	47	4
		Debt Service Capacity	70	44	7
	TYPE AND CRITERIA	Short and Long Term	75	47	7
		Fixed and Variable	45	25	4
		Other Financing	90	42	21



# Results: Debt Structuring Category

		DEBT MANAGEMENT POLICY ELEMENTS	PERCENTAGE ADDRESSING ELEMENT		
			COUNTIES	CITIES	SCHOOL DISTRICTS
DEBT STRUCTURING	STRUCTURAL FEATURES	Call Features	35	14	4
		Maturity	45	36	43
		Credit Enhancement	40	42	4
		Derivative Products	35	19	4

# Results: Debt Issuance Category

	DEBT MANAGEMENT POLICY ELEMENTS	PERCENTAGE ADDRESSING ELEMENT			
		COUNTIES	CITIES	SCHOOL DISTRICTS	
DEBT ISSUANCE	CREDIT OBJECTIVES	Ratings	70	50	7
		Relationships with Credit Raters	60	39	4
	METHOD OF SALE	Competitive vs. Negotiated	45	50	25
		Direct Loans	10	3	0
		Private Placements	30	11	4
		Premium Structures	0	0	0
	SELECTION OF PROFESSIONAL	Request For Proposals (RFP)	20	22	7
		Contract Evaluation and Terms	20	14	4
		Conflicts of Interest	25	11	7
	REFUNDING	Reasons for Refunding	75	44	11

# Results: Debt Management Category

		DEBT MANAGEMENT POLICY ELEMENTS	PERCENTAGE ADDRESSING ELEMENT		
			COUNTIES	CITIES	SCHOOL DISTRICTS
DEBT MANAGEMENT	DISCLOSURE	15c2-12 Requirements	55	19	4
		Initial and Continuing	65	42	11
		Obligated Person to Communicate	55	17	4
	INVESTMENT OF PROCEEDS	Compliance with Federal Tax Law	55	14	7
		Arbitrage Requirements	50	44	11
		Direct to Investment Policy	15	6	4

# Results: Review and Approval

Policy Characteristic	% of County Policies	% of City Policies	% of School District Policies
A stand-alone document	80	28	89
A section in another policy	20	72	11
Dated	80	72	89
Provided for updates	35	17	7
Evidence of approval process	65	61	43

# End Notes

## □ CDIAC Recognizes

- Every element in CDIAC’s review will not apply to every issuers – policy should recognize these situations
- The sampling method surely missed some very well developed debt policies
- The sampling did capture some high scoring policies

### Policies that Included 20 or More Elements

Butte County	Los Angeles USD	City of Fresno
City of Long Beach	Monterey County	Fresno County
San Luis Obispo County	Ventura County	City of Los Angeles
City of Oakland	City of Yuba City	City of Newport Beach
San Diego County	Yolo County	

# DEBT MANAGEMENT GUIDELINES AND PROCEDURES

Joanne Wilson, Financial Analyst



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❑ IMPETUS TO DEVELOP WRITTEN GUIDELINES AND PROCEDURES

- County employees attended a CDIAC workshop in 2006 which focused on the benefits of adopting a debt management policy
  - The presenters provided convincing support to the substantial advantages to adopting clear debt management guidelines
  - Below is an illustration included in that workshop which left the County employees with a lasting impression of the value of having policies in place
  - Development of concurrent policies was encouraged
- Absence of uniform guidelines and procedures to evaluate debt issuance proposals

<b>An Example of the Power of Policies</b>			
<b>Fund Balance Survey 1996</b>			
<b>City</b>	<b>Policy?</b>	<b>If Yes, Description</b>	<b>Actual</b>
Arroyo Grande	No		1%
Atascadero	No		1%
Grover Beach	Yes	20% of operating	20%
Morro Bay	Yes	27.5% of operating	15%
Paso Robles	Yes	15% of operating	13%
Pismo Beach	No		-14%
San Luis Obispo	Yes	20% of operating	21%



## ❑ INITIAL CONSIDERATIONS AND OBJECTIVES

- Document the County's goals for the use of debt instruments
- Articulate the County's debt issuance values prior to encountering pressures
- Include an educational component for all readers
- Provide continuity with staff changes
- Establish guidelines and procedures to:
  - Address long-term capital improvement costs
    - Annually adopt a ten-year Capital Improvement Program (CIP). The CIP ensures planned financings conform to the Debt Management Guidelines and Procedures targets regarding:
      - Magnitude and composition of the County's indebtedness
      - Economic and fiscal resources of the County to bear such indebtedness
    - Minimize the County's debt service and issuance costs
    - Provide for the highest practical credit rating
    - Maintain full and complete financial disclosure and reporting
    - Give structure to debt evaluation
    - Insure the responsibilities for debt administration are understood

## ❑ INITIAL DRAFT OF THE GUIDELINES

- First draft completed in 2006
- Incorporated guidelines from the debt policies of other municipalities
- We knew what we wanted to cover:
  - Table of Contents
    - Objectives
    - Debt Advisory Committee
    - Authority and Responsibility
    - Credit Issuance Guidelines
    - Capital Planning and Financing System for Long-Term Debt
    - Types and Purposes of Debt
    - Methods of Sale and Issuance
    - Selection of Financial Consultants and Service Providers
    - Term and Structure of County Long-Term Debt
    - Credit Ratings
    - Investment of Bond Proceeds
    - Refunding Long-Term Debt
    - Derivatives and Conduit Financings
    - Annual Audited Financial Statements
    - Financial Disclosures, Monitoring, and Recordkeeping
    - Ethics and Conflict of Interest
    - Appendix A – Proposed Financing Form (A feasibility analysis for each proposed financing)

- ❑ EXPANSION OF INITIAL OUTLINE (2010-2013)
  - Final policy adopted in May 2013
  - Incorporated the answers to the IRS Form 14002 – Governmental Bond Financings Compliance Questionnaire
  - Expanded the continuing disclosure, monitoring, and recordkeeping requirements
  - Some resources used:
    - CDIAC Debt Issuance Primer
    - GFOA “A Guide for Preparing a Debt Policy”
    - GFOA “Debt Issuance and Management – A Guide for Smaller Governments”
    - Government Finance Review article (October 1997) “Elements of a Comprehensive Local Government Debt Policy”
    - Standard & Poor’s and Moody’s methodologies and criteria
- ❑ COUNTY’S EXPERIENCE WITH THE DEBT MANAGEMENT GUIDELINES AND PROCEDURES
  - Financing of one large capital project was analyzed and approved pursuant to the adopted Guidelines and Procedures
  - Process of evaluating the debt issuance went extremely smoothly
  - Thorough, transparent analysis

## ❑ ADDITIONAL COMMENTS

- County elected not to refer to the document as “Policy”
- Debt evaluation process:
  - Financing needs are reviewed and analyzed by either the Chief Administrative Officer or the Treasurer depending upon whether it is a long-term or short-term debt issuance
  - If the financing is approved for escalation, a detailed, a written Financing Proposal will be presented to the Debt Advisory Committee.
    - The Financing Proposal must include the following information:
      - Detailed description of the type and structure of the financing
      - Full disclosure of the specific use of the proceeds and justification for borrowing as opposed to “pay-as-you-go”
      - A description of the public benefit to be provided by the project or proposal
      - The principal parties involved in the transaction
      - Anticipated sources of repayment
      - An estimated sources and uses statement
      - Any credit enhancements proposed
      - The anticipated debt rating, if any
      - An estimated debt service schedule and how it compares to the asset life
      - An analysis of the County’s debt ratios after the completion of the financing pursuant to established guidelines
      - An analysis demonstrating the completed project can be supported with ongoing cash flow
      - A thorough explanation of any exceptions to the Guidelines and Procedures

  

## ❑ WHAT NEXT?

- Develop a separate, written Continuing Disclosure Policy as a companion to the [Debt Management Guidelines and Procedures](#)
- Regularly review and update the Guidelines and Procedures, as needed

# CDIAC DEBT POLICY WEBINAR



CITY OF FRESNO – OCTOBER 22, 2014 – 10:00AM TO 11:00AM

# WHY A DEBT MANAGEMENT POLICY?

- Provides guidelines and restrictions, improves quality of decisions, enables consistent debt structure, and aids to ensure long-range financial planning.
- Signals to rating agencies and investors that government is well managed and much more likely to meet its debt obligations.
- When approved by the governing body it provides credibility, transparency and a common understanding and goal among elected officials and staff as to the debt financing approach.

# WHY FRESNO DEVELOPED A POLICY

- City had informal policies encompassing legal debt limits and other legal restrictions. There were no specific guidelines for the structure of debt issuance, particularly in the way of long-term planning with respect to capital improvement programs or reserve policies in the case of economic downturns and revenue declines.
- There were no requirements for annual evaluation of debt obligations using industry standard ratios, to determine if bond obligations should be limited or suspended for a period of time. Such ratios include:
  - Debt per capita; debt to personal income; debt to taxable property value or debt service payments as a percentage of general fund revenue or expenditures for Direct Debt.
  - Evaluation of adequacy of revenue stream (rates set) to meet debt service coverage for Revenue Debt
  - Plans or programs to systematically evaluate and adjust rates as necessary thereby reducing political influences over rates.
- Debt issuances were more politically driven as opposed to financially evaluated and long-range driven.



# WHAT INITIATED THE POLICY DEVELOPMENT?

- Upon election to City Council, Councilmember Brand met with Finance Staff to review the City's CAFR, particularly the City's debt portfolio.
- Upon learning that there was no formal debt policy and staff's desire to have one, the Councilmember took the lead and set about to create a policy.
- Desire to establish long-term comprehensive written policy that was flexible enough to encompass City's needs but also to set specific limits, give consideration to financial impacts, include long term planning considerations and set consistent debt structuring practices and best practices as they relate to Public Policies.

# HOW TO - DEVELOPMENT OF POLICY

- Research consisted of extensive internet searches for existing and well written debt policies, discussions with Finance staff as to their desires, review of existing staff developed internal informal guidelines as well as discussions with external financial professionals and interested parties.
- Guidelines, allowances and restrictions were pulled from various sources as to what were considered best practices. Draft Policy was shared with Finance Staff, City's Financial Advisor, City Chamber of Commerce, various City labor groups, Fresno Business Council, City Executive Management as well as other diverse interested parties. Feedback was provided by all.

# ADOPTION OF DEBT POLICY AND THEREAFTER...

- Debt Management Policy adopted unanimously by Council on February 25, 2010.
- On July 26, 2012, Council voted and directed City Attorney to prepare a ballot measure for the November 6, 2012 election to amend the City Charter for four items as a result of the recommendations of the City Charter Review Commission.
- Measure F included not only the formal adoption by the voters of the Debt Management Policy, but also the Reserve Management Act and the Better Business Act, which established a due diligence process when evaluating requests by the private sector for City financial assistance that exceed \$1 million.
- Passed with 70% voter approval which implies strong public support for these policies.
- Policy thus far has guided refinancing decisions, as well as pre-spending prior to debt issuance. City has had limited debt issuances since its adoption due to economic conditions.

# BRIEF OVERVIEW OF POLICY

- Policy covers:
  - Debit limits –
    - Legal restrictions
      - Local Charter and State constitution and law
    - Financial restrictions / planning considerations
      - Resource constraints, financial conditions, financial ratios
    - Internal Standards
      - Debt purpose
      - Types of debt
      - Relationship to Capital Improvement Program
      - Policy goals related to economic development, revenue streams, etc.
    - Financial Restrictions or Planning Considerations
      - Financial constraints such as refinancing, and financial ratios

# BRIEF OVERVIEW OF POLICY - CONTINUED

- Debt Structuring Practices
  - Maximum terms
  - Average maturity, debt service pattern, use of redemption features, variable or fixed-rate considerations
  - Other structural considerations, such as capitalizing interest, deferral of principal, asset pledges
- Debt Issuance Practices
  - Selection and use of financial advisors, underwriters, bond counsel and other financing team members
  - Determination and criteria for bond sale method (competitive, negotiated, private placement) and investment of proceeds
  - Use of credit ratings, determination of the number of ratings and selection of rating agencies

# BRIEF OVERVIEW OF POLICY - CONTINUED

- Debt Management Practices
  - Investment of bond proceeds
  - Market disclosures
  - Arbitrage rebate monitoring and filing
  - Other compliance practices and considerations

[City of Fresno Debt Management Policy](#)

California Debt and Investment Advisory Commission Webinar

# Principles and Practices of Debt Management

October 22, 2014



School  
Services  
of California  
INC. <sup>TM</sup>

Ron Bennett  
Chief Executive Officer

# Why School Agencies Should Have Debt Policies?



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- Over a long period of time, school agencies received cash in advance for operating budget apportionments and relied on state bonds for capital projects
  - We have seen how quickly that can change during the past recession
  - Most school districts now issue a variety of debt instruments
    - Tax Revenue Anticipation Notes (TRANS)
    - Certificates of Participation (COPs)
    - General Obligation Bonds (GOs)
    - Inter-fund Borrowing
    - Bridge Loans
    - Refunding Instruments



# Why School Agencies Should Have Debt Policies?



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- Debt policies guide the appropriate use of debt for school agencies
  - Tax-supported voter-approved debt vs. appropriation debt
  - Tax rate management
  - Debt structure
  - Appropriate use of short-term and long-term debt
  - Public disclosure
  - Analysis of costs of issuance
- Debt policies help optimize capital funding decisions

# Future Needs for Borrowing



- When the state of California got into financial trouble, it cut budgets but also deferred payments to school agencies
  - We expect those actions will be considered by the state in the next financial crisis
- On the capital budget side, the last statewide school facilities bond was approved in 2006
  - These bonds were once the primary source of capital funding for schools
  - The state has also limited the imposition of higher developer fees
- Local bonds are now the primary source of funding for school facilities
  - Management of local bond issuances, expenditures, and refundings places a higher level of responsibility on local school districts
  - That higher management responsibility should be supported by consistent policies and procedures
- All of this argues for establishment of debt management policies

# School Agency Local Bonds 2012



- In the absence of statewide school bonds, the local elections of 2012 demonstrate the increased reliance on local bonds and public support for those bonds
  - Passage of Proposition 39 in 2000 lowered approval requirement to 55%
- Here is a summary of the results of 2012 elections

Number of General Obligation Bond Elections (Passed)	Total Dollars (In Billions)
116	\$15.3

- The pass rate for 2012, even during a major economic crisis, was 83%, very high by historical standards

# Local School Bonds on the Ballot for November 2014



- The trend toward reliance on local bonds is fueled by the fact that the state has not placed a statewide facilities bond on the 2014 ballot and will not be able to do so until at least 2016
- Here is a summary of the local school bond issues slated for the November 2014 general election

Number of General Obligation Bond Elections (Proposition 39)	Total Dollars (In Billions)
113	\$11.5

- We expect school agencies to again earn a very high passage rate

# Now is the Time to Review Debt Policies



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- We recommend school agencies use the calm before the next storm to get their debt policies in order
  - The California Debt and Investment Advisory Commission (CDIAC) offers outstanding guidance and assistance
  - Some school districts have done excellent work on their policies, notably [Los Angeles Unified School District](#)
  - Assembly Bill 182 of 2014 sets out new legal standards for issuance of capital appreciation bonds: many of those standards have universal applicability
  - County government is ahead of school agencies in the area of debt policy; those examples can help school agencies get started
- School Services of California, Inc., will be following this webinar to ensure school agencies have access to CDIAC best practices information

# QUESTIONS

# Thank you for your participation.

A Certificate of Attendance will be emailed to you by the end of the week.

For MCLE credit, please email [cdiac\\_education@treasurer.ca.gov](mailto:cdiac_education@treasurer.ca.gov)