



## City of Aliso Viejo

# COUNCIL POLICY

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### INTRODUCTION

California Government Code Section 8855 requires any issuer of public debt to provide the California Debt Investment Advisory Commission (CDIAC) with certain reports and information related to the issuance of public debt. Senate Bill 1029 (SB 1029), effective on January 1, 2017, revises the Government Code to require additional reporting requirements delineated below related to the issuance of debt by a local agency.

- A. The purposes for which the debt proceeds may be used.
- B. The types of debt that may be issued.
- C. The relationship of the debt to, and integration with, the issuer's capital improvement program or budget, if applicable.
- D. Policy goals related to the issuer's planning goals and objectives.
- E. 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.

The City of Aliso Viejo (City) believes the Debt Policy set forth in this document is in compliance with SB 1029.

### PURPOSE

The purpose of this Debt Issuance and Management Policy (the "Policy") is to provide written guidelines for issuing debt and managing outstanding debt and to provide guidance to policy makers regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, and method of sale that may be used. Adherence to a debt policy helps to ensure the City's debt is issued and managed prudently in order to maintain a sound financial position and optimal credit ratings. The debt policies and procedures are subject to and limited by applicable provisions of state and federal law and prudent debt management principles.

When used in this Policy, "debt" or "bonds" refers to all indebtedness and financing lease obligations. This Policy is applicable to all entities for which the City Council acts as legislative body. These entities include, but are not limited to, the City of Aliso Viejo and the Aliso Viejo Public Facilities Corporation. When used in this Policy, the term "City" shall refer to each of such entities and "debt" or "bonds" refers to all indebtedness and financing lease obligations of the City.



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### POLICY OBJECTIVES

The main objectives of this Policy include, but are not limited to:

- A. Maintain the City's sound financial position by ensuring the debt capacity is adequately considered and minimizing the City's interest payments and issuance costs.
- B. Protect the City's creditworthiness and achieve the highest practical credit ratings, when applicable.
- C. Provide complete financial disclosure and reporting.
- D. Ensure the City's debt is consistent with the City's planning goals and objectives and capital improvement program and/or budget, as applicable.
- E. Ensure the City is in compliance with all relevant State and Federal securities laws and other applicable laws and regulations.

### ACCEPTABLE USES OF DEBT PROCEEDS

The City will consider the use of long-term debt financing primarily for the acquisition, substantial refurbishment, replacement, or expansion of capital assets and capital improvement projects only if the project's useful life will equal or exceed the term of the financing or will otherwise comply with Federal tax law requirements, or for the purpose of refunding, refinancing, or restructuring debt (including the City's pension obligations), subject to refunding parameters and objectives discussed later in this Policy. Examples of purposes for which long-term debt can be issued include, but are not limited to, the acquisition and/or improvement of land, right-of-way or long-term easements; acquisition of a capital asset with a useful life of a minimum of three years; and the construction or reconstruction of a facility.

An exception of this long-term 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, as described below. Bonded debt should not be issued to finance normal operating expenses. General Fund debt will not be issued to support ongoing operational costs unless such debt issuance achieves net operating cost savings and such savings are verified by independent analysis.

#### A. Long-Term Debt

- (i) Long-term debt may be issued to finance or refinance the construction, acquisition, substantial refurbishment, replacement or expansion of capital assets such as improvements and facilities, equipment and land to be owned and/or operated by the City. Long-term debt financing will not generally be considered for the payment of current operating expenses and routine maintenance expenses. Long-term debt financings are appropriate when any of the following conditions exist:



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- When the financed project is necessary to provide basic municipal services.
  - When the financed project will provide benefit to the City's constituents over multiple years.
  - When the total effect of the debt financing would not impose an unreasonable burden on the City and its taxpayers and/or ratepayers, as applicable.
  - When the debt is issued to refinance outstanding debt in order to restructure debt or produce debt service savings.
- (ii) Long-term debt financing will not generally be considered appropriate for current operating expenses and routine maintenance expenses.
- (iii) When at least one of the above conditions are met, the City may issue long-term debt subject to the following additional conditions:
- The project being financed has been, or will be, included in the City's capital improvement plan or budget and approved by the City Council.
  - The weighted average maturity of the debt allocated to the project will not exceed 120% of the average reasonably expected economic life of the project being financed, subject to exceptions described herein.
  - The City estimates that sufficient income and revenues will be available to pay debt service until final maturity.
  - The City determines that the debt issuance will comply with the applicable requirements of State and Federal law.
  - The City considers the project to be of vital, time-sensitive need for the community and there are no plausible alternative financing sources, such as pay-as-you-go funding, the use of grants or any combination thereof.
- (iv) The City will undertake periodic reviews of outstanding long-term debt to identify refunding opportunities. Refundings may be considered (within the federal tax law constraints, if applicable) if there is a net economic benefit from the refunding. Refundings which have no economic benefit may be considered to alter covenants, call provisions, provide operational flexibility, change tax status, or to restructure the debt service profile in order to achieve City objectives or provide other benefits to the City.

### B. Short-Term Debt

- (i) Short-term debt may be issued to provide financing for the City's operational cash flows in order to maintain a steady and even cash flow balance in the event of temporary shortfalls



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in cash flow for the City due to timing of receipt of revenues and the lack of cash on hand to cover temporary deficits.

- (ii) Short-term debt may also be used to finance the City's short-lived capital projects, such as lease-purchase financing or equipment.
- (iii) Prior to issuance of any short-term debt, a reliable revenue source shall be identified for repayment of the debt.

### C. Financings on Behalf of Other Entities

- (i) In order to further the public purposes of the City, debt may be issued on behalf of other governmental agencies. Prior to issuance, the City shall confirm the financial feasibility of the project being financed, the financial solvency of the borrower and the compliance with this Policy.

## TYPES OF DEBT

In order to maximize the financial options available to benefit the public, the City will consider the issuance of all generally acceptable types of debt, subject first to a careful review by City staff to determine whether it meets the City's long-term objectives. The review shall include an analysis of all available and projected funding sources and how the proposed debt structure would fit within the overall debt portfolio of the City. The City shall not undertake any new debt obligations without a thorough analysis of the City's long-term revenue and expenditure trends, the impact on operational flexibility, overall debt burden on the taxpayer and its ability to support and service additional debt service payments. The generally acceptable types of debt the City may consider include the following:

### A. General Obligation (GO) Bonds

- (i) GO Bonds are backed by the credit and taxing power of the City and are used to finance municipal improvements under certain restrictions. GO Bonds are suitable for use in the construction or acquisition of improvements to real property when the City determines the public interest and necessity demands the acquisition, construction or completion of such municipal improvements which are necessary or convenient to carry out the objectives, purposes, and powers of the City. All GO Bonds shall be authorized by the requisite number of voters in order to pass. Examples of projects include libraries, parks, and public safety facilities.



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### B. Revenue Bonds/Certificates of Participation (COPs)

- (i) Revenue Bonds and COPs are limited-liability obligations tied to a specific enterprise or special fund revenue stream and the financed projects must relate to the enterprise or are a permitted use of the special revenue. Generally, no voter approval is required to issue such bonds and they are not subject to a debt limitation, however the City may need to comply with Proposition 218 regarding rate adjustments.

### C. General Fund-Supported Debt

- (i) General Fund-Supported Debt is generally comprised of COPs and Lease Revenue Bonds (LRBs) which are lease obligations secured by an installment sale or lease-back arrangement between the City and another public entity. Typically, the City appropriates annually available General Fund revenues or funds on hand to pay the lease payments to the other entity and, in turn, the public entity uses the lease payments received by the City to pay debt service on the COPs or the LRBs. Lease-backed debt does not constitute indebtedness under the state or City's constitutional debt limit and does not require voter approval.
- (ii) General Fund-Supported Debt may also include judgment obligation bonds (JOBs) issued to refund obligations imposed by law or pension obligation bonds (POBs) issued to refund unfunded accrued actuarial liabilities for pension plans.

### D. Land-Secured Debt

- (i) Land-Secured Debt is generally comprised of special assessment/special tax debt issued under the Mello-Roos Community Facilities Act of 1982, as amended, by special districts such as Community Facilities Districts (CFDs) and limited obligation bonds issued under applicable assessment statutes by 1913/1915 Act Assessment Districts (ADs).
- (ii) The City will consider requests for special district formation and debt issuance secured by property based assessments or special taxes in order to provide necessary infrastructure for new development under certain guidelines of the City Council (the Statement of Local Goals and Policies), which may include minimum value-to-lien ratios, minimum debt service coverage and maximum tax burdens. Each application will be considered on a case-by-case basis. In order to protect bondholders as well as the City's creditworthiness, the City will also comply with all State guidelines regarding the issuance of special tax or special assessment debt.



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### E. Loans

- (i) The City is authorized to enter into loans, installment payment obligations, or other similar funding structures secured by a prudent source or sources of repayment.

### F. Tax Increment Financing

- (i) Tax Increment Financing provides options to finance infrastructure and economic development projects using as a repayment stream property tax revenues generated above an established "base year" value (tax increment). The City may consider tax increment financing to the extent permitted under State law. Examples include Enhanced Infrastructure Financing Districts (EIFDs) or Community Revitalization and Investment Authorities (CRIAs). When considering tax increment financing mechanisms permitted by law, the City should analyze the practical viability of the proposed financing and take into account the potential impact of the proposed structure on existing debt limitations.

### G. Conduit Financing

- (i) Conduit financing involves the issuance of securities by a government agency to finance a third party's project such as of a non-profit organization or other private entity. Conduit financings are typically not secured by the City's credit. 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 strategic objectives. While conduit financings do not constitute a general obligation of the City, the same level of due diligence prior to bond issuance is required. Examples include industrial development bonds and financings for affordable rental housing and qualified 501(c)(3) organizations.

### H. Joint Powers Authority (JPA) Financing

- (i) In addition to some of the financing instruments described above, the City may also consider joint powers arrangements with other governmental agencies when a project serves the public interest beyond city boundaries.

### I. Refunding Bonds

- (i) As market opportunities arise, the Finance Director shall identify refunding opportunities and prepare an analysis that describes the economic effects of the refunding. Refundings may be undertaken in order to:

- Take advantage of lower interest rates and achieve debt service cost savings.
- Eliminate restrictive or burdensome bond covenants.
- Restructure debt, relieve debt service spikes, reduce volatility in interest rates or free up reserve funds.





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- (ii) Generally, the City shall strive to achieve a minimum of 3% net present value savings. The net present value assessment shall factor in all costs, including issuance, escrow, and foregone interest earnings of any contributed funds on hand. Refundings which produce a net present value savings of less than 3% will be considered on a case-by-case basis. Upon the advice of the Finance Director and with the assistance of a financial advisor and bond counsel, the City will consider undertaking refundings for other than economic purposes based upon a finding that such a restructuring is in the City's overall best financial interest.

### J. Fixed and Variable Rate Bonds

- (i) Debt can be issued as either fixed rate or variable rate debt. For each decision, the City must make a specific determination as to why the chosen rate structure would be beneficial to the City in a specific circumstance.

### K. Other

- (i) 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 Policy. Although alternative financing structures and debt instruments may provide a lower borrowing cost in the short run, they may carry greater risk in the long run. Before entering into such arrangements, the City should carefully evaluate the benefits and risks associated with such alternative financing mechanisms and the potential implications on the City's debt affordability and credit profile.

## STRUCTURE AND TERM OF DEBT ISSUES

The City will establish all terms and conditions related to the issuance of debt, and will control, manage, and invest all debt proceeds. The following restrictions will be followed unless otherwise authorized by the City.

### A. Term of Debt

- (i) Debt will be structured for the shortest practicable period, consistent with a fair allocation of costs to current and future users. Typically, the term of long-term debt borrowing is 5-30 years. Generally, the weighted average maturity of the debt should not exceed 120% of the weighted average economic life of the projects or equipment being financed, unless there are specific circumstances that would mitigate the extension of time to repay the debt and it would not result in violation of any covenants to maintain the tax-exempt status of such debt, if applicable.

### B. Debt Repayment Structure

- (i) In structuring a debt issue, the City will manage the amortization of debt and, to the extent possible, match its cash flow to the anticipated debt service payments. The City shall design the repayment of debt to take best advantage of market conditions, provide



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flexibility, and, as practical, to recapture or achieve its best credit rating. The City will evaluate alternative debt structures to ensure the most cost-efficient financing under prevailing market conditions.

- (ii) The City will generally seek to structure debt with aggregate level annual debt service payments over the life of the debt. Structures with non-level debt service will be considered when one or more of the following exist:

- Natural disasters or extraordinary unanticipated external factors prohibit debt payments in the early years of the issuance.
- Such structuring is beneficial to the City's aggregate overall debt payment schedule.
- Such structuring will allow debt service to more closely match project revenues.

### C. Bond Maturity Options

- (i) For each bond issuance, the City will select serial bonds or term bonds, or both. On occasions where circumstances warrant, capital appreciation bonds (CABs) may be used. The decision to use serial bonds, term bonds or CABs or any combination is typically based on market conditions and investor demand.

### D. Credit Enhancement

- (i) Credit enhancement may be used to improve or establish a credit rating on a City debt obligation. Types of credit enhancement include letters of credit, bond insurance and surety policies. The City's municipal advisor may recommend the use of a credit enhancement if it reduces the overall cost of the proposed financing or if the use of such credit enhancement furthers the City's overall financing objectives.

### E. Debt Service Reserve Fund

- (i) Debt service reserve funds are held by the bond trustee to make principal and interest payments to bondholders in the event that pledged revenues are insufficient to do so. The City will fund debt service reserve funds when it is in the City's overall best financial interest.
- (ii) Under federal tax law, the size of the reserve fund is generally limited to the lesser of 10% of par amount of bonds, 125% of average annual debt service, and 100% of maximum annual debt service.
- (iii) In lieu of holding a cash reserve, the City may substitute a surety bond or other credit instrument in its place. The decision to cash fund a reserve fund rather than to use a credit facility is dependent on the cost of the credit instrument and the investment opportunities.





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- (iv) The City may decide not to utilize a reserve fund or to fund a partial reserve fund if the Finance Director, assisted by the City's municipal advisor, determines there would be no adverse impact on the City's credit rating or interest rates.

### F. Call Provisions

- (i) A call option or optional redemption provision gives the City the right to prepay or retire debt prior to its stated maturity date. This option may permit the City to achieve interest savings in the future through the refunding of the debt. Because the cost of call options can vary depending on market conditions, an evaluation will be conducted in connection with each issuance.
- (ii) In general, the City's debt issues will include a call feature that is no later than ten (10) years from the date of delivery of the debt. The City will generally avoid the sale of non-callable debt. The use of a call option will be evaluated and recommended on a case by case basis.

## STRUCTURE OF SECURITIES

The City will determine on a case-by-case basis whether to sell its bonds through a public sale or a private placement.

- A. Public Sale – There are two methods of public sale of debt, competitive and negotiated. Both methods of sale shall be considered for all issuance of debt to the extent allowed by law, as each method has the potential to achieve the lowest financing cost given the right conditions.
- (i) Competitive Sale – When a competitive bidding process is deemed the most advantageous method of sale for the City, award shall be based upon, among other factors, the lowest offered True Interest Cost ("TIC"), as long as the bid adheres to requirements set forth in the official notice of sale.
- (ii) Negotiated Sale – When a negotiated sale process is deemed the most advantageous method of sale for the City, selection shall be based upon, among other factors, qualifications, experience, pricing ability, and fees.
- B. Private Placement – Such method of sale shall be considered if it is demonstrated to result in cost savings or provide other advantages relative to other methods of debt issuance, or if it is determined that access to the public market is unavailable and timing considerations require that a financing be completed.



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### RELATIONSHIP TO CAPITAL IMPROVEMENT PROGRAM AND OPERATING BUDGET

The City's multi-year Capital Improvement Program (CIP) sets priorities for projects and funding while this Policy provides direction and limitations for proposed financings undertaken to implement the CIP. Debt issuance for capital projects should be incorporated into the Capital Improvement Program and be recommended for City Council approval and integrated with the City Council-adopted annual Operating Budget. Prior to issuance of debt, a reliable revenue source shall be identified to secure repayment of the debt and the annual debt service payments shall be included in the Operating Budget.

The City shall integrate its debt issuances with the goals of its Capital Improvement Program by timing the issuance of debt to ensure that projects are available when needed in furtherance of the City's public purposes.

### POLICY GOALS RELATED TO PLANNING GOALS AND OBJECTIVES

The City is committed to long-term financial planning, maintaining appropriate reserve levels and employing prudent practices in governance, management and budget administration. The City intends to issue debt for the purposes stated in this 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 and prudent financing methods and techniques so as to obtain the highest practical credit ratings (if applicable) and the lowest practical borrowing costs.

It is a policy goal of the City to minimize debt service commitments through efficient planning and cash management. The City will consider debt issuance only in those cases where public policy, equity and economic efficiency favor debt financing over cash funding. Prior to the issuance of debt or other financing obligations, the City will carefully consider the overall long-term affordability of the proposed debt issuance by conducting an objective analysis of the City's ability to support additional debt service payments.

### INTERNAL CONTROL PROCEDURES

When issuing debt, in addition to complying with the terms of this Policy, the City shall comply with other applicable policies regarding initial bond disclosure, continuing disclosure, post-issuance compliance, and investment of bond proceeds such as the City's Post-Issuance and Continuing Disclosure Compliance Policy. The City will periodically review the requirements of and will remain in compliance with the following:



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- Federal securities law, including 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.
- The City's investment policies as they relate to the investment of bond proceeds.
- Government Code Section 8855(k) and the annual reporting requirements therein.

The City shall be vigilant in using bond proceeds in accordance with the stated purpose at the time such debt was issued. The City Manager, Finance Director, or designee will monitor the expenditure of bond proceeds to ensure they were used only for the purpose and authority for which the bonds were issued. Proceeds of debt will be held either by: (a) a third-party trustee or fiscal agent, who will disburse such proceeds to or upon the order of the City upon the submission of one or more requisitions by the Finance Director (or her or his written designee), or (b) by the City, to be held and accounted for in a separate fund or account, the expenditure of which will be carefully documented by the City.

### **AMENDMENT AND WAIVER OF DEBT POLICY**

This Policy will be reviewed and amended from time to time as appropriate subject to City Council approval.

There will be circumstances from time to time when strict adherence to one or more provisions of this Policy is not possible or not in the best interest of the City. If the City staff has determined that a waiver of one or more provisions of this Policy should be considered by the City Council, it will prepare an analysis for the City Council describing the rationale for the waiver and the impact of such waiver on the proposed debt issuance, taxpayers, and the City, as and if applicable. Upon a majority vote of the City Council, one or more provisions of this Policy may be waived for a particular debt financing.

The failure of a debt financing to comply with one or more provisions of this Policy shall in no way affect the validity of any debt issued by the City in accordance with applicable laws.