CITY OF GRAND PRAIRIE DEBT

MANAGEMENT POLICIES

October 14, 2014

Prepared by the Finance Department

Approved by the City Manager
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DEBT MANAGEMENT POLICIES

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AUGUST, 1992
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I. PURPOSE

The Debt Management Policies set forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that (1) the city obtains financing only when necessary, (2) the process for identifying the timing and amount of debt or other financing be as efficient as possible and (3) the most favorable interest and other costs be obtained.

II. RESPONSIBILITY

The primary responsibility for developing financing recommendations rests with the Chief Financial Officer. In developing the recommendations, the Chief Financial Officer shall be assisted by the Cash and Debt Manager, Budget Director, and Controller. The Chief Financial Officer shall hold as follows:

* meet no less than twice a year with Department Managers to consider the need for financing and assess progress on the Capital Improvement Program,

* meet as necessary in preparation for a financing,

* review changes in state and federal legislation,

* review annually the provisions of ordinances authorizing issuance of obligations, and to

* annually review services provided by the Financial Advisor, Bond Counsel, Paying Agent and other service providers to evaluate the extent and effectiveness of services being provided.

Prior to the meetings, the Budget Director and Cash and Debt Manager shall jointly prepare a written report on the status of Capital Improvement Program financing. The report shall be based in part on information collected from the primary capital improvement project managers in the city and shall include a projection of near term financing needs compared to available resources, an analysis of the impact of contemplated financings on the property tax rate and user charges, and a financing recommendation.

In developing financing recommendations, consideration will be given as follows:

* the time proceeds of obligation are expected to remain on hand and the related carrying cost;

* the options for interim financing including short term and interfund borrowing, taking into consideration federal and state reimbursement regulations;

* the effect of proposed action on the tax rate and user charges;

* trends in interest rates;

* other factors as appropriate.

A. **Bond Counsel Involvement**

The Bond Counsel will issue an opinion as to the legality and tax exempt status of any obligations. The city will also seek the advice of Bond Counsel on all other types of financings and on any other questions involving federal tax or arbitrage law. Bond Counsel is also responsible for the preparation of the ordinance authorizing issuance of obligations and all of the closing documents to complete their sale and will perform other services as defined by contract approved by the City Council.

B. **Financial Advisor Involvement**

The city will seek the advice of the Financial Advisor when necessary. The Financial Advisor will advise on the structuring of obligations to be issued, inform the city of various options, advise the city as to how choices will impact the marketability of city obligations and will provide other services as defined by contract approved by the City Council. To ensure independence, the Financial Advisor will not bid on nor underwrite any city debt issues. The Financial Advisor will inform the City Manager of significant issues.

III. SHORT TERM DEBT

A. **General**

Short term obligations may be issued to finance projects or portions of projects for which the city ultimately intends to issue long term debt; i.e., it will be used to provide interim financing which will eventually be refunded with the proceeds of long term obligations.

Short term obligations may be backed with a tax or revenue pledge, or a pledge of other available resources.

The amount of short term obligations due to mature in a year shall not exceed 5% of outstanding long term debt.

Interim financing may be appropriate when long term interest rates are expected to decline in the future. In addition, some forms of short term obligations can be obtained quicker than long term obligations and thus can be used in emergencies until long term financing can be obtained. In some cases when the amount of financing required in the immediate future is relatively small, it may be cheaper for the city to issue a small amount of short term obligations to provide for its immediate needs than to issue a larger amount of long term obligations to provide financing for both immediate and future needs when the carrying costs of issuing obligations which are not immediately needed are taken into account.

B. **Commercial Paper**

Interest rates on commercial paper are generally favorable to an issuer relative to interest on other forms of debt. However, it is not feasible for the city of Grand Prairie to issue commercial paper because the cost of issuance for small issuers is too great and the market for commercial paper from a small issuer is poor. In addition, cities may legally only issue commercial paper for revenue supported projects. However, should the opportunity to participate in a commercial paper issuance pool present itself, the advantages and disadvantages shall be evaluated by the Cash and Debt Manager.

C. **Line of Credit**

With the approval of the City Council, the city may establish a tax-exempt line of credit with a financial institution selected through a competitive process. Draws shall be made on the line of credit when (1) the need for financing is so urgent that time does not permit the issuance of long term debt, or (2) the need for financing is so small that the total cost of issuance of long term debt including carrying costs of debt proceeds not needed immediately is significantly higher.

Draws will be made on the line of credit to pay for projects designated for line of credit financing by the City Council. Only projects which will ultimately be financed with the proceeds of authorized bonds may be so designated.

Borrowings under the line of credit shall be retired with the proceeds of long term debt. Interest on borrowings will be repaid from current revenues. A takeout agreement or alternate financing source will be provided for additional security in addition to the tax or revenue pledge and the available voter authorized bonds.

The Chief Financial Officer (or designee) will authorize draws and the Cash & Debt Manager (or designee) will execute them. The Controller will identify line-of-credit draws and expenditures on the books of account. Internal Audit will quarterly verify compliance and adequacy of documentation.

Additionally, a line of credit may be established to fulfill bond covenant requirements for a reserve fund when permitted under applicable ordinances and it is cost beneficial to do so.

IV. **LONG TERM DEBT**

A. **General**

Long-term obligations will not be used for operating purposes, and the life of the obligations will not exceed the useful life of the projects financed.

Debt service structure will approximate level debt service unless operational matters dictate otherwise.

The city will strive to limit its annual issuance of long term obligations to either $5 million or $10 million to take advantage of small issuer exemptions in the federal arbitrage laws. Should subsequent changes in the law raise these limits, then the city's policies will be adjusted accordingly.

The cost of issuance of private activity bonds is usually higher than for governmental purpose bonds. Consequently, private activity bonds will be issued only when they will economically benefit the city.

The cost of taxable debt is higher than for tax exempt debt. However, the issuance of taxable debt is mandated in some circumstances, and may allow valuable flexibility in subsequent contracts with users or managers of the improvement constructed with the bond proceeds. Therefore, the city will usually issue obligations tax-exempt, but may occasionally issue taxable obligations.

B. **Bonds**

Long-term general obligation or revenue bonds shall be issued to finance significant capital improvements for purposes set forth by voters in bond elections. Additionally, revenue bonds may be issued in response to public need without voter authorization.

Bonds will have an average life of 15 years or less.

A resolution of intent to issue bonds authorizing staff to proceed with preparations shall be presented for the consideration of the City Council when the capital budget is presented.

The city will consider the use of surety bonds, lines of credit or similar instruments to satisfy reserve requirements.

C. **Certificates of Obligation**

Certificates of obligation may be issued to finance permanent improvements and land acquisition, the need for which arose between bond elections. In addition, they may be used to finance cost overruns or to acquire equipment costing at least $25,000. The life of certificates of obligation issued to finance equipment shall match the life of the equipment, which is usually three years.

In accordance with state law, a resolution authorizing publication of notice of intent to issue certificates of obligation shall be presented for the consideration of the City Council no less than 45 days before an expected issuance. The notice of intent shall be published in a newspaper of general circulation in the city once a week for two consecutive weeks with the first publication to be at least fifteen (31) days prior to the sale date.

Certificates of obligation can be backed by revenues eligible to be pledged under state law. Some revenues are restricted as to the uses for which they may be pledged. Water and wastewater revenues may be pledged without limit for water and wastewater purposes, but may only be pledged up to $10,000 for non-water and wastewater purposes.

Certificates of obligation may also be backed by a tax pledge under certain circumstances as defined by law. They may also be backed by a combination tax and revenue pledge.

D. **Public Property Finance Contractual Obligation**

Public property finance contractual obligations may be issued to finance the acquisition of personal property.

E. **Anticipation Notes**

Anticipation Notes empower municipalities to issue debt without giving notice of intent. Anticipation Notes may be secured and repaid by a singular pledge, but not plural pledge, of revenue, taxes, or the proceeds of a future debt issue. Anticipation Notes are authorized by an ordinance adopted by the city.

Anticipation Notes may be used to finance projects or acquisition that could also be financed with Certificates of Obligation.

Anticipation Notes have several restrictions which include:

1) Anticipation Notes issued for general purposes must mature before the seventh anniversary of the date the Attorney General approves the issue,

2) Anticipation Notes may not be used to repay interfund borrowing or a borrowing that occurred 24 months prior to the date of issuance,

3) A governing body may not issue Anticipation Notes that are payable from bond proceeds unless the proposition authorizing the issuance of the bonds has already been approved by the voters.

F. **Negotiated versus Competitive Sale versus Private Placement**

When feasible and economical, obligations shall be issued by competitive rather than negotiated sale. A sale may be negotiated when the issue is predominantly a refunding issue or in other non-routine situations which require more flexibility than a competitive offer allows. Whenever the option exists to offer an issue either for competition or for negotiation, analysis of the options shall be performed to aid in the decision making process.

When a sale is not competitively bid, the city will publicly present the reasons and will participate with the financial advisor in the selection of the underwriter or direct purchaser.

The criteria used to select an underwriter in a competitive sale shall be the true interest cost. In a negotiated sale, the underwriter may be selected through a request for proposals (RFP). The criteria used to select an underwriter in a negotiated sale should include the following:

* Overall experience
* Marketing philosophy
* Capability
* Previous experience as managing or co-managing partner
* Financial statement
* Public finance team and resources
* Breakdown of underwriter's discount
    - Management fee - compensation to the underwriter for their work in structuring the issue.
    - Underwriting fee - compensation to the underwriter for using their capital to underwrite the bonds.
    - Average takedown - the portion of the underwriter's discount used to pay the sales force.
    - Expenses - administrative costs such as underwriter's counsel and administrative fees.

In a negotiated underwriting, the sale will always be negotiated with a consortium of underwriting firms, rather than just one, to preserve some of the benefits of competition.

When cost/beneficial, the city may privately place its debt. Since no underwriter participates in a private placement, it may result in lower cost of issuance. Private placement is sometimes an option for small issues. The opportunity may be identified by the Financial Advisor.

G. **Bidding Parameters**

The notice of sale will be carefully constructed so as to ensure the best possible bid for the city, in light of existing market conditions and other prevailing factors. Parameters to be examined include:

* Limits between lowest and highest coupons

* Coupon requirements relative to the yield curve

* Method of underwriter compensation, discount or premium coupons

* Use of true interest cost (TIC) versus net interest cost (NIC)

* Use of bond insurance

* Deep discount bonds

* Variable rate bonds

* Call provisions

H. **Bond Elections**

Before a bond election, the City Manager, Bond Election Committee members and City Councilmembers will be provided with competent debt capacity analyses, tax and user fee impact projections and other information as directed by the City Manager's Office. The Bond Counsel and Financial Advisor will provide support during the process.

V. **REFUNDING**

The city shall consider refunding debt whenever an analysis indicates the potential for present value savings of approximately 5% of the principal being refunded or at least $200,000. The city will not refund less than 5% of its outstanding debt at one time except in unusual circumstances such as when it intends to change bond covenants.

Private activity bonds may be refunded in a current refunding only.

VI. **CAPITAL LEASING**

Capital leasing is an option for the acquisition of a piece or package of equipment costing less than $500,000.

Leasing shall not be considered when funds are on hand for the acquisition unless the interest expense associated with the lease is less than the interest that can be earned by investing the funds on hand or when other factors such as budget constraints or vendor responsiveness override the economic consideration.

Whenever a lease is arranged with a private sector entity, a tax exempt rate shall be sought. Whenever a lease is arranged with a government or other tax-exempt entity, the city shall strive to obtain an explicitly defined taxable rate so that the lease will not be counted in the city's total annual borrowings subject to arbitrage rebate.

The lease agreement shall permit the city to refinance the lease at no more than reasonable cost should the city decide to do so. A lease which can be called at will is preferable to one which can merely be accelerated.

Since the market for lease financings is relatively inefficient, the interest rates available at any one time may vary widely. Therefore, the city shall obtain at least three competitive proposals for any major lease financing. The net present value of competitive bids shall be compared, taking into account whether payments are in advance or in arrears, and how frequently payments are made. The purchase price of equipment shall be competitively bid as well as the financing cost.

The advice of the city's bond counsel shall be sought in any leasing arrangement and when federal tax forms 8038 are prepared to ensure that all federal tax laws are obeyed.

The city may consider issuing certificates of participation to finance a very large project. Care should be taken because financing costs may be greater than for other types of financing. When possible, the lease agreement will be backed with a tax pledge.

If the city is obligated to make payments more than a year in the future then the agreement will probably be considered debt by the state. However, if the payments are subject to annual appropriation by the City Council, then they may not.

VII. **OTHER TYPES OF FINANCING**

From time to time other types of financing may become available. Examples of these options are debt pools with other entities and low-interest loans from state agencies such as the Texas Water Development Board. At the direction of the Chief Financial Officer, the Cash and Debt Manager will prepare a written analysis of an option. The Cash and Debt Manager's analysis will include consideration of the advice of the city's bond counsel and financial advisor.

VIII. **RATIOS AND RESERVES**

The portion of the city's property tax rate levied for debt service shall not exceed 40% of the total tax rate.

The Water and Wastewater Fund total long term debt outstanding shall not exceed the amount of fund equity.

The city will endeavor to maintain 2.00 coverage for all indebtedness of the Water and Wastewater Fund and 1.50 coverage for the Parks and Recreation Venue Fund.

Debt Service Funds should not have reserves or balances in excess of 1/12 of last year's principal and interest expense except that

(1) the city's Water/Wastewater revenue bond debt service reserves will be maintained at the level of the average annual debt service plus amounts accrued for the next debt service payment,

(2) the City's Parks & Recreation Sales Tax Venue revenue bond reserves will be maintained at the level of maximum annual debt service plus amounts accrued for the next debt service payment.

When revenue supported, tax-backed debt is issued, a debt service reserve or similar alternative backup source from which to pay debt service will be established. The source of the reserve will be determined on a case by case basis. When the revenue source being financed with the debt has become well established, then it will no longer be necessary to maintain the reserve or similar alternative backup source.

IX. OFFICIAL STATEMENT

The Official Statement is the disclosure document prepared by or on behalf of the city for an offering of securities.

A. Responsibility

The preparation of the Official Statement is the responsibility of the Cash and Debt Manager under the supervision of the Chief Financial Officer. Information for the Official Statement is gathered from departments/divisions throughout the city.

B. Timing

The Cash and Debt Manager will begin assembling the information needed to update the Official Statement in December. Capital budget information is expected in September and audited financial statement information is expected in early January. As soon as it is available, audited financial statement information and capital budget information will be incorporated.

After all information has been gathered and assembled, it will be held until approximately 8 weeks prior to the next anticipated bond sale. If the next anticipated bond sale is expected to be more than seven months after fiscal year end, then the prior year's audited financial statement information must be updated using unaudited figures.

At least 8 weeks prior to an anticipated bond issuance, the Official Statement information will be typed. Subsequent timing will be as follows:

* Copies of the first draft are provided to the city's bond counsel and city staff, who will review it for 2 weeks. In the case of a negotiated sale, the underwriter's counsel will also be asked for comments.

* Comments from reviewers should be submitted during the two week review period. About 1 week will be required to make the requested changes. After they have been made, the Official Statement is either sent to print or through a second review.

* During the printing process or the second review, a copy of the draft Official Statement is sent to the rating agencies for their review.

* The printer will need 1 week for printing.

* The preliminary Official Statement should be completed and mailed out to underwriters 2 to 3 weeks prior to the bond sale date.

  - If the sale is negotiated, the preliminary document will be titled "preliminary" with red printed disclosure language and will be called a "red herring".

  - If the sale is competitive, the preliminary statement is complete except for an insert with final interest rates.

* After interest rates have been accepted by the City Council, the document is finalized as follows:

  - In case of a negotiated sale, the entire document is reprinted in final form;

  - In case of a competitive sale, a document disclosing actual final interest rates is prepared and inserted into the Official Statement.

  The final document must be distributed to the underwriter within 7 business days of the date of sale.

X. **RATINGS**

The city's goal is to maintain or improve its bond ratings. To that end, prudent financial management policies will be adhered to in all areas.

Full disclosure of operations will be made to the bond rating agencies. The city staff, with the assistance of the financial advisors and bond counsel, will prepare the necessary materials for presentation to the rating agencies.

The city shall maintain a line of communications with the national rating agencies informing them of major financial events in the city as they occur. The Chief Financial Officer will provide the rating agencies with a quarterly report of financial and economic activity. The Comprehensive Annual Financial Report shall be distributed to the rating agencies after it has been accepted by the City Council.

The rating agencies will also be notified either by telephone or through written correspondence when the city begins preparation for a debt issuance. After the initial contact, a formal ratings application will be prepared and sent along with the draft of the Official Statement relating to the bond sale to the rating agencies. This application and related documentation should be sent several weeks prior to the bond sale to give the rating agencies sufficient time to perform their review.

A personal meeting with representatives of the rating agencies will be scheduled every few years or whenever a major project is initiated.

XI. CREDIT ENHANCEMENTS

Credit enhancements are mechanisms which guarantee principal and interest payments. They include bond insurance and a line or letter of credit. A credit enhancement, while costly, will usually bring a lower interest rate on debt and a higher rating from the rating agencies, thus lowering overall costs.

During debt issuance planning, the Financial Advisor will advise the city whether or not a credit enhancement is cost effective under the circumstances and what type of credit enhancement, if any, should be purchased. In a negotiated sale, bids will be taken during the period prior to the pricing of the sale. In a competitive sale, bond insurance may be provided by the purchaser if the issue qualifies for bond insurance.

XII. SECONDARY MARKET DISCLOSURE

SEC 15c2-12 regulations became effective July 3, 1995. The new regulation requires municipal debt issuers to provide specified financial and operating information for fiscal years beginning on January 1, 1996, or later. The information provided should mirror the information provided in an official statement at the time of a primary offering. The annual financial information is to be sent to the Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) designated by the SEC. Additionally, issuers must notify the State Information Depositories (SIDs) if one exists.

In addition to the financial and operating information any material event must be provided to EMMA and to the state SID's. Municipal debt issuers will be obligated to provide ongoing disclosure on the status of the following material events:

- Principal and interest payment delinquencies
- Nonpayment-related defaults
- Unscheduled draws on reserves
- Unscheduled draws on credit enhancements
- Substitution of credit or liquidity providers, or the failure to perform
- Adverse tax opinions or events affecting the tax-exempt status of the security
- Modifications to rights of security holders
- Bond calls

- Defeasances
- Matters affecting collateral
- Rating changes

The Chief Financial Officer will be designated "Compliance Officer" for disclosure requirements. Levels of reporting will include:

- Quarterly compliance reports to the City Council Finance and Government Committee
- Notification by electronic filing to EMMA, and SID's of material events, with copies to the City Council
- Copies of CAFR and updated tables from the Official Statement to EMMA and SIDs within six months of fiscal year end.

XIII. ARBITRAGE LIABILITY MANAGEMENT

It is the city's policy to minimize the cost of arbitrage rebate and yield restriction while strictly complying with the law.

A. General

Federal arbitrage legislation is intended to discourage entities from issuing tax exempt obligations unnecessarily. In compliance with the spirit of this legislation, the city will not issue obligations except for identifiable projects with very good prospects of timely initiation. Obligations will be issued as closely in time as feasible to the time contracts are expected to be awarded so that they will be spent quickly.

B. Responsibility

Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, the advice of Bond Counsel and other qualified experts will be sought whenever questions about arbitrage rebate regulations arise. The city has contracted for arbitrage rebate services with First Southwest Company.

The Cash and Debt Manager will be responsible for identifying the amount of unspent debt proceeds including interest which is on hand and the Controller will be responsible for ensuring that, to the extent feasible, the oldest proceeds on hand are spent first.

First Southwest will maintain a system for computing and tracking the arbitrage rebate liability. First Southwest will notify the city within 60 days of year end of the amount of accrued liability. First Southwest will also be responsible for notifying the city two months in advance of when a rebate of excess arbitrage earnings is due to the Internal Revenue Service.

The city's bond counsel and financial advisor shall review in advance any arbitrage rebate payments and forms sent to the Internal Revenue Service.

The expenditure of obligation proceeds will be tracked in the financial accounting system by type of issue. Investments will be pooled for financial accounting purposes and may, at the discretion of the Cash and Debt Manager, be pooled for investment purposes. When investments of bond proceeds are co-mingled with other investments, the city shall adhere to the Internal Revenue Service rules on accounting allocations.

Arbitrage rebate costs shall be charged as negative interest revenue to the funds in which the related obligation proceeds were originally deposited.

C. **Internal Interim Financing**

In order to defer the issuance of obligations, when sufficient non-restricted reserve funds are on hand, consideration shall be given to appropriating them to provide interim financing for large construction contracts or parts of contracts. When the appropriations are subsequently re-financed with the proceeds of obligations or other resources, the non-restricted reserve funds shall be repaid. When expenditures are reimbursed from debt issuances, applicable state law and the Internal Revenue Service rules on reimbursements will be complied with so that the reimbursements may be considered expenditures for arbitrage purposes. Requirements are in general:

* The city shall declare its intention to reimburse an expenditure with debt proceeds before paying the expenditure, and will exclude costs such as design and engineering fees or cost of issuance;

* Reimbursement bonds must be issued and the reimbursement made within one year after the expenditure was made or the property financed by the expenditure was placed in service, whichever is later; and

* The expenditure to be reimbursed must be a capital expenditure.

D. **Two Year Spend-out Option**

Arbitrage rebate legislation offers a safe harbor whereby obligations issued for construction will be exempt from arbitrage rebate if certain rules are adhered to and the proceeds are spent within two years. However, if this option is elected and all the proceeds are not spent according to the prescribed schedule, penalties are imposed. The option should be considered when circumstances indicate the city will with certainty be successful in achieving a two year spend -out goal. Such circumstances may include, but are not limited to the following:

* Obligations are issued to finance a variety of small construction projects, not large projects which might be unexpectedly delayed after the issuance. Also, project management understands the requirements and is firmly committed to achieving the spend-out goal.

* Obligations are issued for a single, large high priority project with a relatively short construction period and there is a high level of commitment to speedy completion.

When the two year spend-out option is elected, debt will be issued for an estimated one year of expenditures to provide for unexpected delays of up to a year without incurring penalties.

The exercise of the two year spend-out option will always be coordinated with Bond Counsel and the Financial Advisor.

XIV. **MODIFICATION TO POLICIES**

These policies will be reviewed annually by the Chief Financial Officer and significant changes may be made with the approval of the City Manager. Significant policy changes will be presented to the City Council for confirmation.