

# Debt Management Policy

## Introduction

One of the keys to sound financial management is the development of a debt policy. This need is recognized by bond rating agencies, and development of a debt policy is a recommended practice by the Government Finance Officers Association. A debt policy establishes the parameters for issuing debt and managing the debt portfolio. It provides guidance to the administration regarding purposes for which debt may be issued, types and amounts of permissible debt and method of sale that may be used. The following debt policy is intended to demonstrate a commitment to long-term financial planning. It will be used in conjunction with the Capital Improvement Programs for both the City and School Board. Adherence to this policy will help assure maintenance of the City's double-A credit ratings.

## Guidelines for Debt Issuance

- The City will prepare and update annually a five-year Capital improvement Program (CIP) to be approved by City Council. The CIP will be developed with an analysis of the City's infrastructure and other capital needs, and the financial impact of the debt service required to meet the recommended financing plan. The City will strive to fund at least 10% of the CIP projects' aggregate cost on a cash basis.
- As part of the annual Capital Improvement Program, the Schools shall furnish the City a schedule of funding needs for any school projects for which the issuance of long-term debt is planned.
- Each project proposed for financing through debt issuance will have an analysis performed for review of tax impact and future operating costs associated with the project and related debt issuance costs.
- All proceeds from debt issuance for the City of Roanoke and the City of Roanoke School Board shall be appropriated by City Council.
- Proceeds from the issuance of debt shall be monitored by the investment custodian with regard to arbitrage. Compliance with all applicable federal tax requirements shall be made. The City will coordinate with its investment managers with regard to expected project funds payout so as to maximize investment earnings in light of federal arbitrage requirements.
- Long-term debt will be issued to purchase or construct capital improvements or equipment with a minimum expected life of five years. The City will not use long-term borrowing to finance annual operating needs. The term of any bond issue

will not exceed the useful life of the capital project /facility or equipment for which the borrowing is intended.

- The City will attempt to avoid short-term debt to provide cash flow for annual operations. Debt issued for operating purposes will be limited to cases where there is reasonable certainty that a known source of revenue will be received in the current fiscal year sufficient to repay the debt or where there is a clear financial emergency.
- The City will comply with all applicable U.S. Internal Revenue Service and U.S. Treasury arbitrage requirements for bonded indebtedness in order to preserve the tax-exempt status of such bonds.
- Bond issues should be planned to minimize the frequency of issuance, thereby ensuring the lowest possible costs of issuance. When determining the size of a bond issue, consideration should be given to the need for construction, debt service and capitalized interest funds. Construction fund draw schedules shall be prepared, and projection of conservative earning on unspent bond funds should be made in conjunction with planning of the City's Capital Improvement Program.
- The decision to use bond proceeds to pay interest during construction for revenue-producing projects shall be made on a case by case basis and shall be based on an evaluation of the opportunity cost of funds and the availability of other sources of funds to pay interest costs.
- General obligation bonds will be amortized on a level principal basis to the extent practical, and revenue bonds will be amortized on a level debt service basis to the extent practical considering the forecasted available pledged revenues.
- The City shall not endorse the obligation of any entity other than the City of Roanoke or Roanoke School Board. However, the City may enter into contracts with other regional or local public entities with respect to public purpose projects, which provide for certain payments when project or entity revenues prove insufficient to cover debt service on obligation issued to finance such project(s). The City will enter into these type agreements only when there is long-term public and financial interest in the regional or local project. The obligation could be structured as Moral Obligation Bonds, or with an underlying support agreement or other contractual arrangement. These obligations do not affect the legal debt limit of the City and any payments are subject to annual appropriation. However, if such payments were made, the obligations would be considered tax-supported debt.
- The City's preferred method of sale of bonds is via competitive sale to underwriters. If deemed advantageous, the City may sell bonds via a negotiated sale, private placement, or other method. Coordination will be made with the

City's financial advisor in arriving at a recommendation to issue bonds through a method other than competitive sale.

## **Underwriter Selection**

- **Senior Manager Selection**—The City shall select a senior manager for any proposed negotiated sale. The selection criteria shall include, but not be limited to, the following:
  - Ability and experience in managing transactions similar to that contemplated by the City;
  - Prior knowledge and experience with the City;
  - Ability and willingness to risk capital and demonstration of such risk and capital availability;
  - Quality and experience of personnel assigned to the City's engagement;
  - Financing plan; and
  - Underwriting fees.
- **Co-Manager Selection**—Co-managers may be selected on the same basis as the senior manager. In addition to their qualifications, co-managers appointed to specific transactions will be a function of transaction size and the necessity to ensure maximum distribution of the City's bonds.
- **Underwriter's Counsel**—In any negotiated sale of City debt in which legal counsel is required to represent the underwriter, the appointment will be made by the Senior Manager with final approval from the City.
- **Underwriter's Discount**—The City will evaluate the proposed underwriter's discount against comparable issues in the market. If there are multiple underwriters in the transaction, the City will determine the allocation of underwriting liability and management fees, if any.

The allocation of fees will be determined prior to the sale date; a cap on management fees, expenses and underwriter's counsel fee will be established and communicated to all parties by the City. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any additional expenses must be substantiated.

- **Evaluation of Underwriter Performance**—In conjunction with its financial advisor, the City will evaluate each bond sale after completion to assess the following: costs of issuance including underwriters' compensation, pricing of the bonds in terms of the overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credits.

- **Designation Policies**—To encourage the pre-marketing efforts of each member of the underwriting team, orders for the City’s bonds will be net designated, unless otherwise expressly stated. The City shall require the senior manager to:
  - Fairly allocate bonds to other managers and the selling group;
  - Comply with Municipal Securities Rulemaking Board (MSRB) regulations governing the priority of orders and allocations; and
  - Within 10 working days after the sale date, submit to the City a detail of orders, allocations and other relevant information pertaining to the City’s sale.

## **Limitations on Level of Debt to be Issued and Outstanding**

### **Constitutional and Statutory Limitations:**

- Article VII, Section 10 of the Constitution of Virginia, the Public Finance Act and the City Charter established the City’s Legal Debt Margin at 10% if the assessed value of real estate within the City shown by the last preceding assessment for taxes.
- The Public Finance Act and the City Charter also establish other limits as to the amounts and types of debt the City may issue.

### **Self-Imposed Debt Targets:**

- Net tax-supported debt as a percentage of the total taxable assessed value in the City (including real, personal property, and public service corporations) will not exceed 4%. For all of the City’s self-imposed debt targets, the City may exclude all or a portion of any bonds or leases that are self-supporting.
- Net tax-supported general obligation debt service shall not exceed 10% of General Fund expenditures.
- Net tax-supported debt will be structured in a manner such that not less than 60% of the aggregate outstanding tax-supported debt will be retired within ten years.

## **Types of Debt Issuance**

- The City may issue general obligation debt for capital or other properly approved projects
- The School Board may use the Virginia Public School Authority (VPSA), Qualified Zone Academy Bonds (QZAB), Qualified School Construction Bonds (QSCBs), or State Literary Fund loans to finance school capital projects. Such debt issued on behalf of the School Board constitutes general obligation debt of

the City. The City Manager and the Director of Finance shall approve any application to the Commonwealth of Virginia for such debt. City Council shall approve the issuance of the bonds as required by the Public Finance Act. The School Board shall approve such financings before requesting City Council approval.

- The City may issue revenue bonds to fund proprietary activities such as water and water pollution control utilities, or for other capital projects that generate adequate revenues from user fees to support operations and debt service requirements. The bonds will include written legal covenants which require that revenue sources are adequate to fund annual operating expenses and annual debt service requirements.
- Capital leases may be used to purchase buildings, equipment, furniture and fixtures. The term of any capital lease shall not exceed the useful life of the asset leased. Revenue bonds may be issued by the City or other entity that are secured by a City capital lease.
- Short-term borrowing may be utilized for interim financing or for other purposes as described below. The City will determine and utilize the least costly method for short-term borrowing subject to the following policies:
  - Bond Anticipation Notes (BANs) may be issued for capital related cash purposes to reduce the debt service during the construction period of a project or to provide interim financing for a project. The BANs shall not mature more than 5 years from the date of issuance.
  - Lines of Credit shall be considered as an alternative to other short-term borrowing options.
  - Other Short-Term Debt may be used when such instruments provide an interest rate advantage or as interim financing.
- Lease financing and master lease obligations, including lease revenue bonds, may be considered as alternative financing structures.

## **Refunding of Debt**

The City will refund debt when it is in the best financial interest of the City to do so.

- **Debt Service Savings**—When a refunding is undertaken to generate interest rate cost savings, the minimum aggregate present value savings will be 3% of the refunded bond principal amount. The present value savings will be net of all costs related to the financing. If present value savings is less than 3%, the City may consider the refunding efficiency as measured by option value. If the refunding efficiency of a refunding candidate exceeds 70% (on a maturity-by-maturity basis) and present value savings is less than 3%, the City may opt to increase the universe of refunded bonds.

- **Restructuring**—Refundings for restructuring purposes will be limited to restructuring to alleviate debt service during difficult budgetary years, achieve cost savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants.
- **Term of Refunding Issues**—The City will refund bonds within the term of the originally issued debt. However, the City may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible. The City also may consider shortening the term of the originally issued debt to realize greater savings. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.
- **Escrow Structuring**—The City shall utilize the least costly securities available in structuring refunding escrows. A certificate will be provided by a third party agent stating that the securities were procured through an arms-length, competitive bid process (in the case of open market securities), and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the City from its own account.
- **Arbitrage**—The City shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refundings. Any resulting positive arbitrage will be rebated as necessary according to Federal guidelines.

### **Investor Relations, Disclosure and Communication**

- The debt ratios outlined above will be computed annually and reported in the Comprehensive Annual Financial Report, along with a computation of net tax-supported debt per capita.
- The City will maintain communication with bond rating agencies to keep them abreast of its financial condition by providing them the City's Comprehensive Annual Financial Report, Annual budget, and Capital Improvement Program.
- The City will comply with all of its undertakings in accordance with Securities and Exchange Commission Rule 15c2-21.

### **Debt Service Fund Balance**

- The fund balance of the Debt Service Fund shall be reserved for the future payment of annual principal and interest payments, which includes general obligation bonds of the City, including school debt.

# Glossary

**Advance Refunding.** A refinancing transaction in which new (refunding) bonds are issued to repay (refund) outstanding bonds prior to the first call date. The proceeds of the refunding bonds are deposited in an escrow account, invested in government securities, and used to pay debt service (interest, principal and premium, if any) on the refunded bonds through the applicable call date. For accounting purposes, refunding obligations are not considered a part of an issuer's debt.

**Arbitrage.** The difference between the interest paid on the tax-exempt securities and the interest earned by investing the security proceeds in higher-yielding taxable securities. IRS regulations govern arbitrage on the proceeds from issuance of municipal securities.

**Bond Anticipation Notes (BANs).** Notes which are paid from the proceeds of the issuance of long-term bonds. Typically issued for capital projects.

**Call Provisions.** The terms of the bond giving the issuer the right to redeem all or a portion of a bond prior to its stated date of maturity at a specific price, usually at or above par.

**Capitalized Interest.** A portion of the proceeds of a bond issue which is set aside to pay interest on the same bond issue for a specific period of time. Interest is commonly capitalized for the construction period of the project.

**Capital Lease.** A lease obligation that has met the criteria to be categorized as a capital lease as opposed to an operating lease under generally accepted accounting principles. Capital leases are common in certain types of financing transactions involving the use of revenue bonds as opposed to general obligation bonds.

**Competitive Sale.** A sale/auction of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities. Contrast to a negotiated sale.

**Continuing Disclosure.** The principle that accurate and complete information material to the transaction which potential investors would be likely to consider material in making investment decisions with respect to the securities be made available on an ongoing basis.

**Debt.** Any obligations of the City for the payment of money issued pursuant to the Public Finance Act of Virginia.

**Debt Service Reserve Fund.** The fund in which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements.

**Designation Policies.** Outline how an investor's order is filled when a maturity is oversubscribed when there is an underwriting syndicate. The senior managing underwriter and issuer decide how the bonds will be allocated among the syndicate. There are three primary classifications of orders which form the designation policy: Group Net orders; Net Designated orders and Member orders.

**Escrow.** A fund established to hold moneys pledged and to be used to pay debt service on an outstanding issue.

**Expenses.** Compensates senior managers for out-of-pocket expenses including: underwriter's counsel, DTC charges, travel, syndicate expenses, dealer fees, overtime expenses, communication expenses, computer time and postage.

**General Obligations.** Bonds issued by the City secured by the City's pledge of its full faith and credit and unlimited taxing power.

**Intergenerational Equity.** Equity or fairness principal that those that benefit from a capital improvement should pay for it.

**Legal Debt Margin.** The amount of federal obligation bonds and certain other interest bearing obligations (other than revenue bonds) that the City may have outstanding expressed as a percentage of the assessed value of real estate in the City as shown on the last preceding assessment for taxes.

**Negotiated Sale.** A method of sale in which the issuer chooses one underwriter to negotiate terms pursuant to which such underwriter will purchase and market the bonds.

**Option Value.** Option valuation is a methodology for evaluating the efficiency of a refunding. Option valuation calculates the maximum theoretical value of refunding a bond, then expresses the current refunding savings as a percentage of the maximum theoretical savings.

**Pay-As-You-Go.** An issuer elects to finance a project with existing cash flow as opposed to issuing debt obligations.

**Present Value.** The current value of a future cash flow.

**Private Placement.** The original placement of an issue with one or more investors as opposed to being publicly offered or sold.

**Rebate.** A requirement imposed by Tax Reform Act of 1986 whereby the issuer of tax-exempt bonds must pay the IRS an amount equal to its profit earned from investment of tax-exempt bond proceeds at rates exceeding the tax-exempt borrowing rate. The tax-exempt borrowing rate (or "bond yield") is calculated pursuant to the IRS code together with all income earned on the accumulated profit pending payment.



**Refunding.** A transaction in which the City refinances an outstanding issue by issuing new (refunding) bonds and using the proceeds to immediately retire the old (refunded) bonds.

**Revenue Bonds.** Bonds issued by the City secured by a specific revenue pledge of rates, rents or fees.

**Tax -Supported Debt.** Debt that is expected to be repaid from the general fund tax revenues of the City. This includes general obligation bonds, appropriation-supported bonds, capital leases and in certain circumstances moral obligation bonds. For the purpose of this Debt Policy, net tax-supported debt includes general obligation debt for the City and School Board, certain bonded capital leases, and any moral obligation bonds for which the City has deposited funds to a debt service reserve fund as requested to replenish such reserve fund.

**Underwriter.** A dealer that purchases new issues of municipal securities from the Issuer and resells them to investors.

**Underwriter's Discount.** The difference between the price at which bonds are bought by the Underwriter from the Issuer and the price at which they are reoffered to investors.