COUNCIL POLICY NO. C-2

TITLE: DEBT MANAGEMENT POLICY

POLICY: See attachment.

REFERENCE: Finance Committee Report dated 8/17/15, Agenda Item No. 3.a (Supplants Finance Committee Reports dated 8/12/13, Agenda Item No. 3.2(e), 2/8/2010, Agenda Item No. 4.2 (b); Finance Committee Report dated 8/4/2008, Agenda Item No. 4.2 (b); Finance Staff Report on CIP dated 4/7/1997, Agenda Item No. 7.2.n; Audit Subcommittee Report dated 5/3/1999, Agenda Item No. 4.2 .t)

CITY OF SALEM
DEBT MANAGEMENT POLICY

I. Purpose

The purpose of the City of Salem's debt management policy is to manage the issuance of the City's debt obligations, retain or improve the existing bond rating, and maintain the City's ability to incur debt and other long-term obligations at favorable interest rates for capital improvements, facilities and equipment beneficial to the City and necessary for essential services.

II. Scope

This Policy provides general guidance for the issuance and management of all City debt.

III. Comprehensive Capital Planning and Financing System

The City plans long and short-term debt issuance to finance its capital improvement program based on cash flow needs, sources of revenue, capital construction periods, available financing instruments and market conditions. The City will develop and maintain a capital planning process, such as the annual Capital Improvement Program (CIP), for consideration and adoption by the City Council.

The Finance Division is responsible for analyzing debt requirements, requesting City Council authorization to issue debt, and coordinating the debt issuance. This includes timing of debt, calculation of outstanding debt, debt limitation calculations and compliance, impact on future debt burdens, current revenue requirements, and available unrestricted fund balance.

IV. Authority to Issue Bonds

The Oregon Revised Statutes, Chapter 287A authorizes the City to issue general obligation bonds, revenue bonds, and refunding bonds and to borrow funds for municipal purposes. Under the City Charter, the City Council authorizes the issuance of bonds and notes of indebtedness and the City Manager is responsible for seeing that the terms of all contracts and agreements are fulfilled.

V. Credit Objectives

In determining a city's credit worthiness, bond rating agencies review the following general factors:

A. **Local Economy** – the strength of the local economy and its influence on the ability to repay the debt.

B. **Outstanding Debt** – the amount and structure of a city's overall debt is considered relative to the community's ability to pay.

C. **Financial Environment** – revenue and expenditure trends and the status of reserves and fund balances for the city.

D. **Strength of Management Practices and Strategies** – established policies and practices of the city that promote strategic and financial planning.

E. **Meet the City's goal to maintain or improve its bond ratings** – to that end, prudent financial and management policies will be established and adhered to in all areas. Full disclosure of operations will be made to the bond rating agencies. The City will strive to maintain an underlying rating in the double "A" range from one or more of the major rating agencies.

VI. Factors

The City will issue debt only for the purposes of acquiring or constructing capital improvements and equipment, and for making major renovations to existing capital improvements for the good of the public. Exceptions to this rule will be considered on a case-by-case basis, if the contemplated debt is in the best interests of the City. Before issuing any new debt the City will consider the following factors:

1. Global, national and local financial environment
2. Current interest rates
3. Expected interest rate changes
4. Condition of local economy
5. Cash and investment position (e.g., the availability of cash on hand for project)
6. Current debt position (e.g. current and projected coverage ratios)
7. Availability of funds to repay
8. Flexibility to cover future needs
9. Urgency of current capital needs
10. Opportunity to leverage debt with a grant or other low-cost financing mechanism

VII. Limitations on Indebtedness

The City will maintain a conservative debt position based on the factors listed above. Pay-as-you-go and replacement programs will be utilized whenever feasible to avoid financing costs. Debt will be issued only if the benefits outweigh the costs of the debt.

ORS 287A.050 limits general obligation debt to a maximum of 3% of the City's real market value. City Council further restricts general obligation debt to a maximum of 1.5% of the City's real market value.

VIII. Types of Debt

A. **Long-Term Debt:**
Depending on the specific circumstances, the City may use the following types of long-term (more than two years) financing instruments:

1. General Obligation Bonds (GOs): Bonds that are secured by a commitment to levy ad valorem real property taxes outside the limits imposed by Ballot Measure 5 and Ballot Measure 50. General obligation bonds must be first approved by vote of the electors of the City.

2. Full Faith and Credit Obligation (FF&C): Bonds or promissory notes that are not secured by a commitment to levy ad valorem real property taxes outside the limits imposed by Ballot Measure 5 and Ballot Measure 50, but which covenant the full faith and credit of the City to budget and appropriate all legally available funds to pay debt service for those bonds. Full Faith and Credit Obligations may be issued without voter approval.

3. Certificates of Participation (COPs): Financing technique provides long-term financing through a lease or lease-purchase agreement. It is not subject to other statutory requirements applicable to bonds, including the requirement of a vote of citizens.

4. Revenue Bonds: Bonds secured by a specific revenue stream other than ad valorem real property taxes.

5. Master Lease Agreements (Public/Private Lease-Purchase Agreements): A lease agreement with a provider or bank to lease equipment or buildings. The terms of the lease should coincide with the life of the equipment to be leased and a tax-exempt rate shall be sought. Before entering into a Master Lease Agreement, the City will seek to obtain the lowest rate possible using competitive bidding.

6. Pooled Financing: The pooling of debt with other governmental entities and the use of low-interest loans from state agencies or other organizations on either a long-term or short-term basis. Pooled Financing will be considered if it is financially or strategically beneficial to the City.

7. Assessment Bonds: Bonds backed by assessments on real property for public improvements authorized by the property owners or developer that specially benefit the assessed properties. Assessment Bonds are also referred to as "Bancroft Bonds."

B. Short-Term and Interim Debt:

Short-term obligations (less than two years) may be issued in anticipation of particular revenues, such as taxes or grants, and such revenue may be pledged for repayment of the debt issuance. Interim debt may also be issued to finance projects or portions of projects for which the City ultimately intends to issue long-term debt. Short-term and/or interim financing shall not exceed ten percent of outstanding long-term debt, unless there is a situation that needs immediate attention in order to address an emergency or that allows for significant cost savings. Other situations warranting short-term obligations may be identified, upon the recommendation of the Finance Director.

Interim financing may be appropriate when long-term interest rates are expected to decline in the near future. In addition, some forms of short-term obligations can be obtained quicker than long-term obligations and can be used in urgent situations until long-term financing can be obtained.

Short-term Obligations and Interim Financing include:

1. Line of Credit: A credit source extended to a business by a bank or financial institution. The line of credit creates an account that can readily be tapped into if the need arises or not touched at all and saved for emergencies. Interest is only paid on the money actually taken out. . Draws shall be made on the line of credit when the need for financing is so urgent that time does not permit the issuance of long-term debt or the need for financing is so small that the total cost of issuance of long-term debt would be prohibitive.

2. Pooled Financing: (see VIII.A.6. above)

3. Internal Financing: (see section VIII.C. below)

4. Inter-Governmental Financing: (see section VIII.C. below)

5. Internal Interim Financing: Should the City desire to issue bonds for large capital projects, the City can, upon passage of an intent-to-issue resolution, use non-restricted reserve funds as interim financing to pay a portion of project costs that will be repaid with bond proceeds. This type of financing will be reviewed by Bond Counsel to ensure the City is in compliance with applicable federal tax rules.

6. Other types: The City may consider the use of Tax Anticipation Notes, Bond Anticipation Notes, Revenue Anticipation Notes, Commercial Paper, derivatives or other such structured borrowings if it is in the best financial interests of the City to do so.

C. Internal and Inter-governmental Financing:

Internal Financing: The City may meet internal financing needs if the City Council determines it is in the City's best financial interest to do so. The City may also enter into an inter-governmental agreement (IGA) between the City of Salem and Urban Renewal Agency for the City of Salem to provide financing for urban renewal activity, when the City Council determines it is in the City's best interest to do so. The same analysis conducted for internal financings above will be conducted for inter-governmental agreements. Consideration will be given to:

- Length of the borrowing term: The maximum term for a capital loan is limited to ten years, and the maximum term for an operating loan is limited to one year. See ORS 294.468(2)(a-d) and (3).

- Cost-benefit analysis: The rate of interest and borrowing costs from external sources must be weighed against the current and anticipated interest earnings for internal funds.

- The borrowing fund's ability to repay the loan.

- Budget authority.

1. Interest Rate on Internal Financings: Financings shall bear an annually adjusted interest rate of .50% above the City's combined portfolio rate. The initial rate shall be based on the City's prior year's combined portfolio rate, and shall be recalculated at the beginning of each fiscal year based on the prior fiscal year's combined portfolio rate. Existing short-term loans with a variable interest rate will be converted to a fixed rate.

2. Interest Rate on Inter-governmental Financings (a.k.a. government-to-government financing): Inter-governmental agreements shall bear an annual interest rate equal to 1.00% above the City's prior year's combined portfolio rate, and shall be recalculated at the beginning of each fiscal year based on the prior fiscal year's combined portfolio rate.

D. Conduit Debt:

The City may sponsor conduit financings for those activities by other entities authorized by law to use conduit financing, if the proposed conduit financing has a general public purpose, are in the best interest of the City, and are authorized by Oregon law. All conduit financings must insulate the City completely from any credit risk or exposure, and must be approved by the City Council. The City shall collect a $10,000 fee for each issuance of conduit debt.

IX. Structural Features of Debt:

A. Taxable and Tax-exempt Debt:

The cost of taxable debt is higher than the cost of tax-exempt debt. However, the issuance of taxable debt is mandated in some circumstances, and may allow flexibility in subsequent contracts with users or managers of the improvement constructed with bond proceeds. Therefore, the City will usually issue obligations tax-exempt, but may occasionally issue taxable obligations when there is an expected benefit from doing so.

B. Maturity:

The term of City debt issues shall not exceed the useful life of the project or equipment financed. The repayment of principal on tax supported debt should generally not extend beyond twenty years.

C. Bond Insurance:
Bond insurance is an insurance policy which can be purchased by the City, guaranteeing the payment of principal and interest due on the bond. This security provides a higher credit rating and a lower borrowing cost for an issuer. The purchase of bond insurance will be considered on a case-by-case basis through a cost-benefit analysis and will be acquired when it is in the best interest of the City.

D. Surety and Debt Service Reserve Funds:
Surety and Debt Service Reserve Funds are used to provide a ready reserve to meet current debt service payments should monies not be available from current revenues to pay principal and interest when due to bondholders. The City will utilize the methodology to calculate Surety and Debt Service Reserve Funds that best serves its needs on a case-by-case basis.

E. Coverage Requirements:
Coverage is the ratio of pledged revenues to related debt service for a given year. For each bond issue, the Finance Division, in conjunction with the financing team, shall determine the appropriate coverage requirements, if any.

F. Use of Variable-Rate Securities:
When appropriate, the City may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities. However, the City will generally avoid use of variable-rate debt due to the potential volatility of such instruments.

G. Level Debt Service:
Every effort will be made to structure principal and interest payments in a manner that minimizes fluctuations in annual debt service payments and the impact on the property tax levy and/or user fees to meet debt service requirements. Exceptions may be made to allow matching debt service to a specific revenue stream or to maintain a level tax levy.

H. Call Provisions:
The City will seek to structure debt agreements with flexible call provisions in order to take advantage of favorable market conditions.

X. Investment of Bond Proceeds

Investment of bond proceeds will be consistent with those authorized by Oregon law and by the City's investment policy and applicable bond covenants. Bond proceeds shall be invested and tracked separately from other investments. The City may contract with a bond trustee to invest and track the bond proceeds in accordance with bond covenants.

XI. Arbitrage Liability Management

Arbitrage is the profit made by issuing bonds bearing interest at tax-exempt rates, and investing the proceeds at materially higher taxable yields. The Internal Revenue Code limits the opportunity for borrowers to use moneys associated with tax-exempt bonds to acquire

materially higher yielding taxable investments. If a profit is made which does not meet the allowable exception rules, the excess profit must be "rebated" to the Internal Revenue Service. Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, qualified arbitrage professionals will perform arbitrage calculations in strict adherence to applicable laws and regulations. These calculations will be done in accordance with required Internal Revenue Service reporting dates, which are five years after the delivery date of each issue, and each fifth year thereafter, until the bonds have matured, or been redeemed early or retired.

It is the City's policy to minimize the cost of arbitrage rebate and yield restriction while strictly complying with the applicable laws. The City Manager will be responsible for identifying the amount of unspent debt proceeds including interest which is on hand, and to the maximum extent feasible, shall ensure the oldest proceeds on hand are spent first.

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

XII. Refinancing of Outstanding Debt

A. Advance Refundings:

A procedure whereby outstanding bonds are refinanced by the proceeds of a new bond issue. Typically an advance refunding is performed to take advantage of interest rates that are significantly lower than those associated with the original bond issue or to remove restrictive language. The City may issue Advance Refunding Bonds (as defined for federal tax law purposes) when advantageous, legally permissible, prudent and a net present value savings of at least three percent is provided. Exceptions to the requirement may be made only upon the recommendation of the City Manager.

B. Current Refundings:

The City may issue Current Refunding Bonds (as defined for federal tax law purpose) when advantageous, legally, prudent and net present value savings equal or exceed three percent.

C. Restructuring of Debt:

The City may choose to refund outstanding indebtedness when existing bond covenants or other financial structures impinge on prudent and sound financial management. Savings requirements for Current Refundings or Advance Refundings undertaken to restructure debt may be waived by the City Council upon a finding that such a restructuring is in the City's overall best financial interests.

XIII. Ongoing Disclosure

In accordance with the Securities and Exchange Commission (SEC), Rule 15c2-12, the City will provide financial and operating information to the Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) designated by the SEC. The City will also provide its annual financial statements and other relevant information to rating agencies, paying agent, and banking institutions, as required by continuing disclosure

requirements within all debt documents. The City shall comply with the continuing disclosure requirements by filing its annual financial statements and other relevant information through Disclosure USA or other generally accepted electronic repository.

XIV. Method of Sale

There are three ways the City may sell bonds: competitive (public) sale, negotiated sale and private placement.

1. Competitive Sale: When determined appropriate by the City Council, the City may sell debt obligations in a manner in which any interested underwriter is invited to submit a proposal to purchase an issue of bonds. The debt obligation is awarded to the underwriter presenting the best bid according to criterion set forth in the notice of sale. The criterion used to select an underwriter in a competitive sale shall include the True Interest Cost. The City shall seek to issue debt obligations by competitive sale, unless City Council determines that such a method would not produce the best results for the City.

2. Negotiated Sale: When determined appropriate by the City Council, bonds may be sold through an exclusive arrangement between the City and an underwriter. At the end of successful negotiations, the issue will be awarded to the underwriter.

   Negotiated Sales offer flexibility that may be advantageous for the City. In a negotiated sale, the underwriter is selected through the Request for Proposal process. The criteria used to select an underwriter in a negotiated sale should include, but not be limited to the following: overall experience, marketing philosophy, capability, underwriter's discount, and expenses. The City Manager may waive the requirement for a Request for Proposals, if necessary to meet emergency financing needs.

3. Private/Direct Placement: When determined appropriate by the City Council, the City may elect to sell its debt obligations through a private/direct placement or limited public offering. If the City anticipates several private placement financings, the City may elect to complete a Request for Proposal process in order to establish a Financing Entity of Record. The services of a financial advisor or placement agent may be obtained to assist in the Request for Proposal process.

XV. Assembling a Financing Team

A Financing Team will be assembled to provide professional services that are required to develop and implement the City's debt program with the goal of continuity, quality service and competitive prices.

Bond Counsel: The City Manager, with input from the City Attorney, shall select bond counsel. The bond counsel's role is to prepare or review and advise the issuer regarding authorizing resolutions or ordinances, trust indentures, official statements, validation proceedings and litigation. All debt issued by the City will include a written opinion by bond counsel affirming that the City is authorized to issue the proposed debt. The opinion

shall include confirmation that the City has met all city and state constitutional and statutory requirements necessary for issuance, a determination of the proposed debt's federal income tax status and any other components necessary for the proposed debt.

Underwriters: The City Manager shall solicit proposals for underwriting services for all debt issued in a negotiated sale. The Underwriter is responsible for purchasing negotiated debt and reselling the debt to investors.

Financial Advisor: The City Manager shall select a financial advisor. The financial advisor shall provide services for all debt issued in a negotiated, competitive or private placement sale.

City Staff: The City Manager shall designate the Finance Director and any other City staff members deemed appropriate to coordinate the efforts of the hired consultants and the City.

XVI. Rebate Reporting and Covenant Compliance

The Finance Director shall establish a system of record keeping, written procedures and reporting to meet the arbitrage rebate and monitoring and private use limitation compliance requirements of the federal tax code. This effort shall include tracking investment earnings on bond proceeds and expenditures of bond proceeds, calculating rebate payments in compliance with tax law, remitting any rebatable earnings to the federal government in a timely manner, and actively monitoring compliance and the uses of bond-financed assets throughout the entire life of the debt to preserve the tax-exempt status of the City's outstanding debt issues.

It shall be the primary responsibility of the Finance Director to ensure that appropriate accounting records of tax-exempt bond expenditures are maintained for a period of time that allows the City to comply with its arbitrage rebate requirements. The Finance division shall document and monitor compliance for appropriate record-retention timeframes based upon current legal requirements and industry best practices. City departments issuing debt are responsible to promptly notify the Finance department of any issues surrounding the appropriate use of tax-exempt bond proceeds or facilities financed with tax exempt bonds.

Additionally, general financial reporting and certification requirements embodied in bond covenants shall be monitored to ensure that all covenants are complied with.

XVII. Modification to Policy

The City Council Finance Committee will review this policy as needed, but at a minimum, every five years. The Finance Director will review this policy annually, and make recommendations for changes when needed.

Glossary

Ad Valorem Tax: a tax calculated "according to the value" of property. Such a tax is based on the assessed valuation of real and tangible personal property.

Advance Refunding: a procedure whereby outstanding bonds are refinanced by the proceeds of a new bond issue. Typically an advance refunding is performed to take advantage of interest rates that are significantly lower than those associated with the original bond issue or to remove restrictive language.

Arbitrage: the difference between the interest rate cost of a debt instrument and the rate of interest earned on the investment of the proceeds. Federal law limits the amount of interest cities earn on proceeds of debt issuance.

Assessment Bonds: special obligations of the municipality which are payable solely from the proceeds of the special assessments levied for an assessable project.

Bond: includes bonds, debentures, notes, certificates of indebtedness, mortgage certificates, or other obligations or evidences of indebtedness of any type or character.

Bond Anticipation Note (BAN): a short-term debt instrument issued by a state or municipality that will be paid off with the proceeds of an upcoming bond issue.

Bond Counsel: an attorney (or firm of attorneys) retained by the issuer to give a legal opinion concerning the validity of the securities. Bond counsel may prepare or review and advise the issuer regarding authorizing resolutions or ordinances, trust indentures, official statements, validation proceedings, disclosure requirements and litigation.

Bond Insurance: an insurance policy purchased by an issuer, which guarantees the payment of principal and interest of an issue. This security provides a higher credit rating and thus a lower borrowing cost for an issuer.

Capital Improvement Plan: a plan outlining capital needs for a specified time period.

Capital Lease: an acquisition of a capital asset over time rather than merely paying rent for temporary use. A lease-purchase agreement, in which provision is made for transfer of ownership of the property for a nominal price at the scheduled termination of the lease, is referred to as a capital lease.

Conduit Bonds: conduit financings are securities issued by a government agency to finance a project of a business, whose activities have a general public purpose. The business receives all

proceeds of the tax-exempt bond issue and is responsible for payment of the debt in its entirety. The City of Salem provides conduit financing for the Salem Hospital.

Competitive Sale: a bond sale conducted through a sealed bid, containing price and terms, submitted by a prospective underwriter(s) to an issuer, who awards the contract to the bidder with the best price and terms.

Continuing Disclosure: the requirement by the Securities and Exchange Commission for most issuers of municipal debt to provide current financial information to the informational repositories for access by the general marketplace.

Coverage: the ratio of pledged revenues to related debt service for a given year.

Debt Service Reserve Fund: the fund into which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements. This is often established with debt proceeds.

Derivatives: a financial product, the value of which is derived from the value of an underlying asset, reference rate, or index. Typically these agreements are contracts between a lender/investor and a borrower.

Financial Advisor: a consultant who advises an issuer on matters pertinent to a debt issue, such as structure, sizing, timing, marketing, pricing, terms and bond ratings.

Financing Team: the group of professionals consisting of City staff, Bond Counsel, Underwriters and Financial Advisors that work together to issue bonds.

General Obligation Bonds (GO): bonds which are secured by the full faith and credit and taxing power of the municipality and use funds that are legally available for payment of debt service. A city can issue ad valorem GO bonds with voter approval, which are repaid solely from ad valorem taxes, or non-ad valorem bonds which are repaid from legally available general fund revenues by a covenant to budget and appropriate.

Master Lease Agreement: a pre-determined lease agreement between a city and a provider to lease equipment whose useful life is too short to finance with long-term debt.

Negotiated Sale: underwriting of a new securities issue in which the spread between the purchase price paid to the issuer and the public offering price is determined through negotiation with one or more underwriters rather than multiple competitive bidding.

Paying Agent: an agent of the issuer with responsibility for timely payment of principal and interest to bond holders.

Present Value: the value of a future amount or stream of payments stated in current dollars. Project: any capital expenditure the City Council deems to be for a public purpose.

Reserve Fund: a fund established by the terms of a bond issue into which money is deposited for payment of debt service in case of a shortfall in current revenues.

Revenue Anticipation Note (RAN): a short-term debt issue of a municipality that is to be repaid out of anticipated revenues. When the revenue is collected, the RAN is paid off.

Revenue Bond: a bond payable from a specific source of revenue and to which the full faith and credit of an issuer is not pledged. Revenue bonds are payable from identified sources of revenue and do not permit the bondholders to compel a jurisdiction to pay debt service from any other source. Pledged revenues often are derived from the operation of an enterprise.

Tax Anticipation Note (TAN): a short-term obligation of a state or municipal government to finance current expenditures pending receipt of expected tax payments.

Underwriter: the firm that purchases a securities (bond) offering from a governmental issuer for resale.

Yield Restriction: the investment of bond proceeds in financial instruments that earn interest rates which are not significantly higher than the cost of borrowing.