CITY OF LONG BEACH

C-7

DEPARTMENT OF FINANCIAL MANAGEMENT

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January 10, 2017

HONORABLE MAYOR AND CITY COUNCIL
City of Long Beach
California

RECOMMENDATION:

Adopt the Debt Management Policy pursuant to Section 8855 of the State of California Government Code. (Citywide)

DISCUSSION

In September 2016, Senate Bill 1029 (SB 1029) was enacted. This bill amended Government Code 8855 requiring local governments to prepare and submit accountability reports to the California Debt and Investment Advisory Commission (CDIAC). SB 1029 also mandated local governments to adopt debt policies 30 days prior to any debt issuance after January 21, 2017. Additionally, any proposed debt issuance must include a certification by the City stating that it has adopted debt policies related to the use of debt, and that the contemplated debt issuance is consistent with the adopted debt policies.

This Debt Management Policy meets the requirements of Government Code 8855 as amended, and is consistent with the recommendations of the Government Finance Officers Association (GFOA). These requirements and recommendations include:

1. Purpose for which debt proceeds may be used;
2. The types of debt that may be issued;
3. The relationship of the proposed debt issuance to the City's budget and capital improvement program;
4. Policy objectives; and,
5. Internal control procedures that the City has implemented to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

This matter was reviewed by Deputy City Attorney Richard F. Anthony on December 14, 2016 and by Assistant Finance Director Lea Eriksen on December 19, 2016.

TIMING CONSIDERATIONS

In order to comply with the State of California Government Code 8855, City Council approval is requested on January 10, 2017. The Debt Management Policy must be adopted 30 days prior to any debt issuance after January 21, 2017.

FISCAL IMPACT

There is no fiscal or local job impact associated with this recommendation.

SUGGESTED ACTION:

Approve recommendation.

Respectfully submitted,

JOHN GROSS
DIRECTOR OF FINANCIAL MANAGEMENT

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ATTACHMENT

APPROVED:

PATRICK WEST
CITY MANAGER

City of Long Beach, California

Debt Management Policy

January 10, 2017

Table of Contents

1. Introduction

The City may issue a variety of debt obligations to finance its capital projects, infrastructure improvements, and acquisition of capital equipment. While the issuance of debt is often an appropriate method of financing, it is important to effectively manage the City's debt portfolio in order to maintain its financial flexibility, credit strength, and compliance with State and Federal regulations.

2. Purpose

The purpose of this Debt Management Policy is to provide a framework and guidance for the City's debt management program and related activities. The City issues various forms of debt obligations including notes, bonds, capital leases, and other types of financings. This Debt Management Policy is designed to establish parameters for the issuance and uses of debt instruments.

3. Objective

The objective of this Debt Management Policy is to (1) obtain accessibility to the capital markets; (2) ensure financial flexibility; (3) preserve, and/or achieve the highest practical credit ratings; (4) ensure the lowest cost of capital; (5) minimize the City's risk exposure; and, (6) ensure compliance with State and Federal regulations.

4. Debt Management Responsibilities

The City Treasurer's Office will be responsible for managing all of the City's debt-related activities from origination to completion. In addition, the Treasurer's Office will also administer the City's post-issuance compliance. These activities include, but are not limited to the following:

- Issue debt obligations (new money or refinancing) on behalf of the City
- Determine the appropriate debt instrument and structure of the transaction
- Perform industry research and financial analyses (credit rating, debt capacity, and cash-flow)
- Selection of the financing team including municipal financial advisors, bond underwriters, consultants, and other service providers
- Lead and conduct the due diligence review process for financial, lease, and legal documentation
- Manage relationships with rating agencies and the investor community
- Administer bond compliance requirements including arbitrage rebate and yield restriction, disclosure, and debt covenants

5. Credit Worthiness Objectives

The City shall seek to maintain the highest practical credit ratings for all categories of short and long-term debt obligations.

6. Integration of Capital Improvement Plan

The City's Capital Improvement Plan (CIP) will identify capital funding needs and these needs will be used to assist in planning future debt issuances.

7. Standard Use of Debt Financing

The City will evaluate practical funding options before making a final decision on the use of debt financing. Debt will generally be used for long-term capital projects such as buildings, parking structures, and infrastructure improvements. Other factors that may be considered in determining the use of debt include debt capacity, credit rating impact, and social and economic benefits.

8. Internal Controls and Approvals

The City Treasurer's Office will maintain oversight responsibility for all debt financing activities. All debt financings should undergo a review process to ensure the integration of the proposed financing with the City's budget and CIP. The City should also maintain a multi-level approval process for any proposed debt issuance. This approval process consists of the respective department, Department of Financial Management, City Attorney's Office, City Manager's Office, and City Council. All debt financing proceeds will be used in accordance with the financing documents. City departments will be responsible for ensuring debt proceeds are spent for their intended purposes. Additionally, drawdown requisitions with the supporting documentation should be submitted and filed through the City Treasurer's Office.

9. Types of Financings

The City will evaluate the use of all types of financing alternatives including short- and long-term debt obligations. The City will also utilize the most cost advantageous financing alternative while limiting the risk exposure to the City's General Fund.

Short-Term Debt Obligations

The City may issue short-term debt obligations for the temporary funding of operational cash flow deficits or anticipated revenues. This includes the following:

- Bond Anticipation Notes (BANs): The City may issue BANs in anticipation of the issuance of general obligation bonds. Typically, BANs have a final maturity of no more than five years from the issuance date.
- Tax and Revenue Anticipation Notes (TRANs): The City may issue TRANs, which are short-term notes, payable from revenues of the current fiscal year. TRAN proceeds will allow the City to cover periods of cash shortfalls resulting from a mismatch between timing of revenues and expenditures.

- Commercial Paper Notes (CP Notes): The City may issue CP Notes to provide interim funding for capital expenditures. CP Notes have a maturity of up to 270 days and may be rolled over for additional intervals of up to 270 days each.
- Lines-of-Credit: The City may enter into line-of-credit agreements with commercial banks or financial institutions to provide short-term funding governed under the terms and conditions in such agreements.

Long-Term Debt Obligations

The City may issue long-term debt obligations when required capital improvements cannot be financed from current resources. Long-term debt obligations should be self-supporting and structured such that debt requirements do not exceed the expected useful life of the project. The City may issue the following long-term debt obligations, but is not limited to:

- General Obligation Bonds (GOs): The City may issue GO bonds upon receiving a two-thirds majority voter approval. GO bonds are backed by the taxing power of the City and paid from property tax revenues.
- Lease Revenue Bonds/Certificates of Participation (COPs): The City may issue lease revenue bonds/ COPs to finance the acquisition, improvement, and construction of real property, or the acquisition of capital equipment. Lease revenue bonds/ COPs require the City to make annual budget appropriations to pay the debt service payments.
- Revenue Bonds: The City may issue revenue bonds that are secured by the revenues generated by the financing project. Typically, revenue bonds are issued by the City's enterprise departments including the Airport, Harbor, Gas and Oil, and Water.
- Special Assessment/Special Tax Bonds: The City may issue Special Assessment/ Special Tax bonds which are paid by revenues generated from the formation of an Assessment District or Special Tax. Generally, these bonds are used for local public improvements such as streets, street lights, and sidewalks.

Other Types of Debt Obligations

The City may issue other types of debt obligations including, but is not limited to:

- Capital Leases: The City may enter into a lease agreement whereby the City agrees to budget and appropriate annual lease payments for capital equipment (e.g., computers, servers, or vehicles).
- Conduit Debt: A conduit debt obligation is issued by the City to finance a project developed/owned by a non-governmental third party. This arrangement is typically used for a qualified non-profit organization and multi-family housing projects. Conduit debt is not a liability of the City.
- Variable Rate/ Derivatives: The City may issue variable rate/derivatives so long as it is consistent with its credit worthiness objectives, applicable securities laws, and pre-existing bond covenants.

10. Structuring Considerations

- Length of Debt: Generally, the City should structure debt obligations for the shortest period, and consistent with available financial resources and the useful life of the asset.

- Debt Structure: The City should structure its debt obligations to achieve the lowest cost of capital given market and economic conditions, the urgency or importance of the capital asset, and the repayment source. Furthermore, to the extent possible, the City should structure repayment of its overall debt to rapidly recapture its debt capacity for future use.

- Backloading: The City will strive to structure its debt obligations with level debt payments over the life of the obligation. However, the City may also structure debt obligations by "Backloading" its debt payments. Backloading debt obligations will only be considered under the following circumstances: (1) unanticipated external factors make the short-term cost of the debt prohibitive; (2) the benefits derived from the debt issuance are clearly demonstrated to be greater in the future than in the present; (3) structure is beneficial to the City's overall debt amortization schedule; and, (4) the structure allows debt service to closely match project revenues during the early years of the project's operation.

- Subordinate Lien Debt: The City may issue subordinate lien debt if it is financially beneficial to the City, or consistent with its creditworthiness objectives.

11. Credit Enhancements

The City may use credit enhancements to improve or establish a credit rating on a City debt obligation, or if it reduces the overall cost of the proposed financing. The City may use credit enhancements including:

- Bond Insurance: The City may purchase bond insurance if deemed prudent economically advantageous. Bond insurance is an unconditional pledge from a bond insurance company that guarantees debt service payments in the event of a default.

- Debt Service Reserve Fund (DSRF): In most cases, the reserve requirement for a debt service reserve fund should be equal to the lessor of 10 percent of the original principal amount, 100 percent of the maximum annual debt service (MADS), or 125 percent of the average annual debt service.

- Letters of Credit (LOC): The City may enter into an LOC agreement to provide additional security to a debt obligation. An LOC is an unconditional pledge from a banking institution that guarantees the repayment of debt service payments in the event of a default.

12. Debt Capacity

The City will maintain a moderate debt level that is consistent with its credit worthiness objectives. For general obligations bonds, the City will comply with California Government Code Section 43605 and not exceed 3.75 percent of the City's total assessed valuation of taxable property within City boundaries.

13. Methods of Sale

The City Treasurer's Office will determine the best method of sale for public offerings. When determining the method of sale, the City Treasurer's Office should take into consideration the credit quality, structure, size, and scope of the proposed financing. The City should also consider the cost of issuance, market conditions, and economic environment. The City may utilize the following methods of sale:

- Competitive Bid: In a competitive sale, underwriters submit sealed bids and the underwriter or underwriting syndicate with the lowest cost to the City should be awarded the transaction. In a competitive sale, the City and its Municipal Advisor set the structure of the transaction prior to receiving bids.

- Negotiated Sale: In a negotiated sale, the underwriter or underwriting syndicate is selected through a Request for Proposal (RFP). In a negotiated sale, the City negotiates the interest rate and the underwriter's fee prior to the sale. This method of sale also allows the City the option to modify the structure of the transaction to meet investor demand (i.e., bifurcate maturities), and modify the financing schedule based on market conditions.

- Private Placement: A private placement provides funding through direct negotiation with one or a select number of private financial institutions. Generally, private placements do not have to be registered with the Securities and Exchange Commission (SEC) and do not require many of the disclosure requirements found in public offerings. As such, private placement bonds are not publicly issued or traded, and do not require a rating from a credit rating agency.

14. Refinancing Outstanding Debt Obligations

The City Treasurer's Office closely monitors the City's outstanding debt for potential savings. Generally, the City should seek a minimum of 3 percent in present value savings of the outstanding par amount of a single bond issue or on a credit aggregate basis. However, in some instances, the City may refinance its outstanding debt obligations for other than economic purposes, such as restructuring debt, changing the type of debt instrument, or eliminating unfavorable debt covenants.

15. Selection of Financing Team

The City Treasurer's Office shall conduct RFPs to select and establish a pool of qualified firms to provide professional services including municipal financial advisors, bond underwriters, bond/disclosure counsel, and other service providers. Once the pool of qualified firms is established, the City Treasurer's Office should select a syndicate that best meets the required expertise and execution capabilities for the proposed financing (e.g., general purpose, utility, or transportation). The City Treasurer's Office reserves the authority to discontinue or issue a new RFP due to changes in the financial industry such as consolidations/mergers, or bankruptcies. Any costs or fees associated with professional services rendered for the issuance of debt should be paid from financing proceeds or by the respective department.

16. Arbitrage Rebate and Yield Restriction Compliance

The City will comply with the Internal Revenue Service (IRS) arbitrage rebate and yield restriction requirements for its tax-exempt financings.

- Arbitrage Rebate: Arbitrage is the difference earned from investing low yielding tax-exempt bond proceeds in higher yielding taxable securities. With certain exceptions, any interest earned above the arbitrage yield is generally required to be remitted to the federal government every fifth bond year from the bond issuance date and upon retirement of the bonds.
- Yield Restriction: The IRS allows tax-exempt bond issuers to earn interest up to the arbitrage yield or interest paid on the bonds. Yield restriction applies to bond proceeds that remain unspent outside a temporary period.

The City Treasurer's Office may elect to retain a third party service provider to assist with post-issuance tax compliance matters. The City Treasurer's Office will also maintain records and comply with reporting requirements in accordance with the IRS rules and regulations.

17. Annual Continuing Disclosure Reporting

The City will prepare and file annual continuing disclosure reports to the Municipal Securities Rulemaking Board's (MSRB) Electronic Municipal Market Access (EMMA) website until the debt obligations are retired. The annual continuing disclosure reports will be filed in accordance with the City's Continuing Disclosure Agreements (CDA). The CDAs enumerate specific reporting requirements related to the City's operations and financial condition. Please refer to the City's Disclosure Policy for guideline and compliance with all applicable disclosure requirements under the federal securities laws in connection with the City's debt obligations.