

**COUNCIL POLICY
CITY OF CHULA VISTA**

SUBJECT: City Debt Policy

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DATED: January 9, 2014

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BACKGROUND

The following policies have been developed to provide guidance in the issuance and management of debt by the City of Chula Vista. The main objectives are to establish conditions for the use of debt; to ensure that debt capacity and affordability are adequately considered; to minimize the City's interest and issuance costs; to maintain the highest possible credit rating; to provide complete financial disclosure and reporting and; to maintain financial flexibility for the City.

Debt, properly issued and managed, is a critical element in any financial management program. It assists in the City's effort to allocate limited resources to provide the highest quality of service to the public. The City understands that poor debt management can have ripple effects that hurt other areas of the City. On the other hand, a properly managed debt program promotes economic growth and enhances the vitality of the City of Chula Vista for its residents and businesses.

PURPOSE

To establish a formal City debt policy.

POLICY

GENERAL POLICIES

The Finance Team

All debt issued by the City of Chula Vista shall be under the direction of the City Manager or Finance Director/Treasurer, with the Mayor and City Council providing final approval at a public meeting. The City Manager or Finance Director/Treasurer will determine the composition of the "Finance Team" involved in each issuance. The Finance Team may consist of both City Staff and outside finance professionals. The Finance Director/Treasurer shall decide which City Staff to include on the Finance Team. Critical outside finance professionals include:

- Underwriter: markets and sells debt to investors
- Financial Advisor: independent financial expert providing advice to the City on all aspects of debt
- Bond Counsel: legal counsel that prepares the resolutions, ordinances, agreements and other legal documents required
- Disclosure Counsel: provides legal advice on all disclosure documents and issues in connection to the financing. May be same entity that provides Bond Counsel services.
- Trustee: typically a commercial bank or trust company responsible for the collection and repayment of principal and interest to bondholders, as well as administering the investment of reserve funds, accounting and disbursement of bond proceeds
- District Consultant: provide special district expertise, statistics, data analysis, and disclosure

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support in the issuance of Special District debt.

Selection of Outside Professionals

When identifying members of the Financing Team, the selection of underwriters and financial consultants providing professional services shall be based upon qualifications, experience, and cost; typically through a formal Request for Proposal (RFP) Process. Procurement of other services related to the issuance of debt shall be through a competitive bidding process whenever reasonable.

Depending on circumstances it may be advantageous for the City to participate in a pooled debt issuance with a number of local agencies where issue costs are shared and the underwriters and/or financial consultants are pre-selected by the managing organization. Due to the overall cost savings involved, programs such as the California Statewide Communities Development Authority's "Tax and Revenue Anticipation Note" program are options for the City to consider.

Use of Debt

The City will consider the use of debt financing primarily for capital improvement projects (CIP) when the project's useful life will exceed the term of the financing and when resources are identified sufficient to fund the debt service requirements. Some exceptions to this CIP driven focus are the issuance of debt such as Pension Obligation Bonds, where the financial benefits are significantly greater than the costs and where the benefits are determined to be a financially prudent option; and short-term instruments such as tax and revenue anticipation notes, which are to be used for prudent cash management purposes. Bonded debt should not be issued for projects with minimal public benefit or support, or to finance normal operating expenses.

If a department has any project which is expected to use debt financing, the department director is responsible for expeditiously providing the Finance Department with reasonable cost estimates, including specific revenue accounts that will provide payment for the debt service. This will allow the Finance Department to do an analysis of the project's potential impact on the City's debt capacity and limitations.

TYPES OF DEBT INSTRUMENTS

In order to maximize the financial options available to benefit the public, it is the policy of the City of Chula Vista to allow for the consideration of issuing all generally accepted types of debt, including, but not exclusive to the following:

- **General Obligation (GO) Bonds:** General Obligation Bonds are suitable for use in the construction or acquisition of improvements to real property that benefit the public at large. Examples of projects include libraries, parks, and public safety facilities. All GO bonds require a 2/3 vote in order to pass.
- **Revenue Bonds:** Revenue Bonds are limited-liability obligations tied to a specific enterprise revenue stream where the projects financed clearly benefit or relate to the enterprise. An

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example of projects that would be financed by a Revenue Bond would be improvements to the sewer system, which would be paid back with money raised from the property owner's sewer bills. Generally, no voter approval is required to issue this type of obligation but must comply with proposition 218 regarding rate adjustments.

- Lease-Backed Debt/Certificates of Participation (COP): Issuance of COP debt is a commonly used form of debt that allows a City to finance projects where the debt service is secured via a lease or installment agreement and where the payments are budgeted in the annual budget appropriation by the City from the general fund. Lease-Backed debt does not constitute indebtedness under the state or the City's constitutional debt limit and does not require voter approval.
- Special Assessment/Special District Debt: the City will consider requests from developers for the use of debt financing secured by property based assessments or special taxes in order to provide for necessary infrastructure for new development only under strict guidelines adopted by City Council, which may include minimum value-to-lien ratios and maximum tax burdens. Examples of this type of debt are Assessment Districts (AD) and Community Facilities Districts (CFD) or more commonly known as Mello-Roos Districts. In order to protect bondholders as well as the City's credit rating, all Rate and Method of Apportionment (RMA) documents must include the provision that the maximum projected annual special tax revenues must equal 110% of the projected annual gross debt service on any bonds of the community facilities district. The City will also comply with all State guidelines regarding the issuance of special district or special assessment debt. For further information, refer to the City of Chula Vista Statement of Goals and Policies Regarding the Establishment of Community Facility Districts.
- Industrial Development Bonds – Industrial Development Bonds (IDBs) are tax-exempt securities which can fund manufacturing businesses or energy development projects which provides a public benefit. While the authorization to issue IDBs is provided by a state statute, the tax-exempt status of these bonds is derived from federal law (IRS Code Section 103(b) (2).
- Tax Allocation Bonds – Tax Allocation Bonds are special obligations that are secured by the allocation of tax increment revenues that were generated by increased property taxes in the designated redevelopment area. Tax Allocation Bonds are not debt of the City. Due to changes in the law affecting California Redevelopment agencies with the passage of ABX1 26 as codified in the California Health and Safety Code, the City of Chula Vista Redevelopment Agency (RDA) was dissolved as of February 1, 2012, and its operations substantially eliminated but for the continuation of certain enforceable RDA obligations to be administered by the City of Chula Vista Successor Agency. The terms of ABX 1 26 requires successor agencies perform all obligations with respect to enforceable debt obligations, which include Tax Allocation Bonds.
- Multi-Family Mortgage Revenue Bonds – The City Housing Authority is authorized to issue mortgage revenue bonds to finance the development, acquisition and rehabilitation of multi-family rental projects. The interest on the bonds can be exempt from Federal and State

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taxation. As a result, bonds provide below market financing for qualified rental projects. In addition, the bonds issued can qualify projects for allocations of Federal low-income housing tax credits, which can provide a significant portion of the funding necessary to develop affordable housing. For further information, refer to the Chula Vista Housing Authority – Multi-Family Administrative Bond Policies.

- HUD Section 108 Loan Guarantee Program – The U.S. Department of Housing and Urban Development (HUD) Section 108 Loan Guarantee Program allows cities to use their annual Community Development Block Grant (CDBG) entitlement grants to obtain federally guaranteed funds large enough to stimulate or pay for major community development and economic development projects. The program does not require a pledge of the City’s General Fund, only of future CDBG entitlements. By pledging future CDBG entitlement grants as security, the City can borrow at favorable interest rates because of HUD’s guarantee of repayment to investors.

DEBT AFFORDABILITY AND LIMITATIONS

Debt capacity and affordability will be determined by conducting various analyses prior to the issuance of bonds. The analysis of debt capacity should cover a broad range of factors including but limited to the following:

- Statutory or constitutional limitations affecting the amount that can be issued, such as legally authorized debt limits and tax or expenditure ceilings
- Other legal limitations, such as coverage requirements or additional bonds tests imposed by bond covenants
- Evaluation of trends relating to the government’s financial performance, such as revenues and expenditures, net revenues available after meeting operating requirements, reliability of revenues expected to pay debt service and unreserved fund balance levels
- Debt service as a percentage of total General Fund Revenues

The City will attempt to limit the total amount of annual debt service payments payable by the General Fund to no more than 10% of estimated total General Fund revenues. Under State Law, general obligation bonds shall not exceed 15% of total assessed valuation within the City.

An analysis using current market rates and conservative projections showing compliance with the debt affordability limitations included in this Debt Policy shall be conducted before the issuance of any debt with a maturity longer than two years from date of issue.

Data showing direct and overlapping debt levels for the City of Chula Vista and surrounding agencies that affect the residents of the City shall be compiled for inclusion in the Comprehensive Annual Financial Report (CAFR) of the City.

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DEBT STRUCTURING

In order to maximize financial flexibility in a constantly-changing debt market, the City shall be allowed to structure its debt issuances using generally accepted methods.

The guiding principal shall be to structure debt issuances so that the City's overall costs are minimized while still maintaining or increasing the City's credit rating. Allowable structures include, but are not limited to the issuance of:

- Serial and/or Term Bonds: Serial Bonds are those in an issue that mature in consecutive years, whereas Term Bonds comprise a large part or all of a particular issue that come due in a single maturity but are prepared in part each year.
- Fixed and Variable Rate Debt: Fixed rate debt is when an interest rate on a security does not change for the remaining life of the security, where Variable rate debt or "floating rate" changes at intervals according to market conditions or a predetermined index or formula.
- Zero Coupon: Zero Coupon is an original issue discount bond on which no periodic interest payments are made but is issued at a deep discount from par, accreting (amortized) to its full value at maturity.
- Capital Appreciation: Capital Appreciation occurs when the investment return on an initial principal amount is reinvested at a stated compounded rate until bond maturity. The investor receives a single payment (maturity value), representing both the initial principal amount and the total investment return.
- Bonds with Capitalized Interest: Bonds with capitalized interest have a portion of the proceeds of an issue set aside to pay interest on securities for a specified period of time.
- Senior and Junior Lien Structures: Senior Lien bonds have a priority claim against pledged revenues, while Junior Lien bonds have a subordinate claim against pledged revenues or other security.

Debt service should be structured so that annual combined principal and interest payments do not dramatically vary year over year. This provides greater budget stability. Limited exceptions from level debt service will be allowed for individual debt issues when level debt service is unsuitable; for instance in the case of some refunding of debt.

Redemption provisions should generally be included in most issuances, providing they are structured in a reasonable and cost-efficient manner as determined by the Financing Team. Redemption options include but are not limited to:

- Optional Redemption: a call or prepayment provision option that is giving to the issuer, often only on or after a specified date.
- Mandatory Redemption: to require the issuer to redeem or call the bond "in-whole redemption" which is all at once, or "partial redemption" which is only a portion on a scheduled basis.

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Credit enhancement, such as letters of credit or insurance, may be purchased when the cost of enhancement is more than recovered by the debt service savings created. Entering into a financing utilizing letters of credit or insurance must be planned for and determined to be feasible by the Director of Finance/Treasurer.

Maximum Maturity

Debt obligations shall have a maximum maturity of the earlier of:

- the reasonably estimated useful life of the Capital Improvements being financed; or,
- thirty years; or,
- in the event they are being issued to refinance outstanding debt obligations the final maturity of the debt obligations being refinanced, unless a longer term is recommended by the Finance Team.
- Such other terms which meet the financing goals of the debt issuance.

DEBT ISSUANCE

The City will strive to minimize borrowing costs by:

- Seeking the highest credit rating possible;
- Maintaining transparency and excellent communications with credit rating agencies regarding the City's fiscal condition;
- Purchasing bond insurance or taking action to upgrade the City's current credit rating

It shall be the policy of the City to allow the issuance of debt through public sale or private placement, and via competitive or negotiated sales underwriting methods. Consistent with the goal of minimizing costs, competitive sale shall be the primary method of sale considered unless the Financing Team decides that a negotiated sale is warranted. Factors that may impact this decision include:

- Issuer/Issue Recognition: competitive sales are easier for an issuer that investors and underwriters are familiar with. If extensive marketing is needed to educate the market about the issuer, a negotiated sale maybe more appropriate. Similarly, even if the issuer is well-known, if the issue itself has a "story" that needs to be told, a negotiated sale may be needed to enhance the marketing and acceptance of the debt.
- Issue Size: very large or very small deals may benefit from a negotiated sale over a competitive sale.
- Debt Type: GO bonds and other well-known and accepted debt structures are suitable for competitive sales. Others such as CFDs, variable rate, or innovative structures may benefit from a negotiated sale.
- Credit Ratings: issuers with high credit ratings and insured bonds lend themselves to competitive sales. Uninsured or lower rated issues are often more suitable for negotiated sales.

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- Sale Timing: during times of market uncertainty when conditions are volatile, the flexibility of a negotiated sale may allow an issuer to adjust the sale date and capture additional interest rate savings.

The City will seek to issue refunding bonds with the minimum goal of 5% net present value savings of the par value of the proposed bonds. Anything less than an anticipated 5% savings will require additional analysis discussing the benefits of the refunding due to the cost associated with refunding debt. Consideration shall be given to the benefit of delaying a refunding in a declining interest rate environment to capture maximum savings at the least cost.

DEBT MANAGEMENT PRACTICES

Disclosure

The City will comply with Rule 15(c) 2-12 of the Securities Exchange Commission (SEC) and provide timely disclosure of relevant information on an annual basis as well as any material event notices as required.

The City recognizes the importance of accuracy in disclosure documents and will strive to provide full and complete disclosure. To ensure accuracy of stated facts, directors of any department that originally provided or produced any data appearing in a disclosure document will provide a written statement certifying the accuracy of their department's data along with a statement denying knowledge of any misstatements or material omissions in the remainder of the disclosure document.

The City will fulfill its obligations as covenanted in all the Continuing Disclosure Agreements associated with any active issuance. Documents are distributed through Electronic Municipal Market Access (EMMA) which can be viewed at any time by the public.

The City will determine on a case-by-case basis whether or not to retain the services of an independent disclosure counsel.

For additional information regarding disclosure procedures, please refer to Administrative Disclosure Procedures.

Arbitrage

In the past, agencies took advantage of their ability to borrow at tax-exempt rates and invest the proceeds at higher rates, thus earning positive arbitrage. Since 1986, the federal tax code requires issuers of long-term, tax-exempt debt to rebate positive arbitrage to the federal government. The City will diligently monitor its compliance with all federal arbitrage regulations. Due to the complex nature of arbitrage calculations, the City may elect to hire an outside expert consultant to perform this function.

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Compliance with Tax Law Provisions

The City will diligently monitor its compliance with all bond legal covenants, as well as Federal and State requirements, with the assistance of its Finance Team and consultants. Furthermore, recognizing that the smallest of mistakes can lead to the appearance of conflicts of interest or wrongdoing, which in turn may lead to severe consequences, including criminal charges, the City will make every effort to ensure its debt financing conduct is above reproach.

Investment of Bond Proceeds

The City shall comply with Federal and State regulations governing the investment of bond proceeds. Each issue shall detail allowable investments within the Trust Agreements, which the City will adhere to. Where not specifically spelled out, the City will apply the City investment policy guiding principal commonly referred to as "SLY"; Safety, Liquidity, and Yield, in that order of priority.

Records Retention

The City will retain records sufficient to demonstrate compliance with the requirements of federal and California law necessary to preserve the tax advantage of such City Bonds for the period required by law, presently understood to be the life of the debt obligations or any succeeding refunding obligations plus 3 years.

Other Provisions

Bond proceeds, reserve, and repayment funds, should have separate accounting from operating or other funds, at a level distinct enough to facilitate arbitrage compliance calculations and ease debt service and expenditure tracking.

If any part of this Debt Policy conflict with Federal or State laws, or the City of Chula Vista Municipal Code, or Charter, the regulations will take precedence over this Debt Policy.