

# CITY OF SEDONA

## Debt Management Policy

### Introduction

The City of Sedona (City) maintains conservative financial policies to assure strong financial health both in the short- and long-term. The City is an infrequent issuer of debt and intends to continue that practice.

This policy sets forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that (1) the City obtain financing only when necessary, (2) the process for identifying the timing and amount of debt or other financing be as efficient as possible, (3) the most favorable interest rate and other related costs be obtained, and (4) when appropriate, future financial flexibility be maintained.

Debt financing, which includes general obligation bonds, special assessment bonds, revenue bonds, temporary notes, lease/purchase agreements, and other City obligations permitted to be issued or incurred under Arizona law, shall only be used to purchase capital assets that cannot be acquired from either available current revenues or fund balances.

### Guidelines for Use

Debt financing will not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The City will use debt financing only for one-time capital improvement projects and unusual equipment purchases, only when estimated future revenue is sufficient to ensure the repayment of the debt obligation, and when at least one of the following factors apply:

1. Other funding options have been explored and are not viable for the timely or economic acquisition or completion of a capital project.
2. A capital project is mandated by federal or state authorities with no other viable funding option available.
3. The capital project or asset lends itself to debt financing rather than pay-as-you-go funding based on the expected useful life of the project and worthiness to future generations.
4. Any City debt issued in support of a capital project will first be reviewed and approved under the auspices of the City's general plan, an approved master plan, or a Community Focus Area (CFA).

The City will primarily rely on current revenue and cash set-asides to finance its capital improvements. The City believes in funding a significant portion of capital improvements on a "pay-as-you-go" basis. The following criteria will be used to evaluate "pay-as-you-go" vs. debt financing:

### **Factors Which Favor Pay-As-You-Go Financing:**

- The project can be adequately funded from available current revenues and fund balances.
- The project can be completed in an acceptable timeframe given the available revenues.
- Additional debt levels could adversely affect the City's credit rating or repayment sources.
- Market conditions are unstable or suggest difficulties in marketing a debt.

### **Factors Which Favor Long-Term Debt Financing:**

- Revenues available for debt issues are considered sufficient and reliable so that long-term financing can be marketed with an appropriate credit rating, which can be maintained.
- Market conditions present favorable interest rates and demand for City debt financing.
- A project is mandated by state or federal government, and current revenues or fund balances are insufficient to pay project costs.
- A project is immediately required to meet or relieve capacity needs, and existing available cash reserves are insufficient to pay project costs.
- The life of the project or asset financed is five years or longer.

## **Types of Permitted Debt**

City debt will be structured to achieve the lowest possible net interest cost to the City given market conditions, the urgency of the capital project, and the nature and type of any security provided. City debt will be structured in ways that will not compromise the future flexibility to fund projects.

City debts will be amortized for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users, and in keeping with other related provisions of this policy.

Unless specific compelling reasons exist, there shall be no "balloon" bond repayment schedules, which consist of low annual payments and one large payment of the balance due at the end of the term.

At a minimum, the City will seek to amortize bonds with level principal and interest costs over the life of the issue. Pushing higher costs to future years in order to reduce short-term budget liabilities will be considered only when natural disasters or extraordinary or unanticipated external factors make the short-term cost of bonds prohibitive.

The following is a listing of the types of permitted debt and general guidelines as to their use.

#### **A. General Obligation (G.O.) Bonds.**

G.O. bonds provide the investor with its most secure City transaction, because the City's pledge of its unlimited authority to levy property taxes for debt services.

The sum of all G.O. debt outstanding is governed by the City's statutory legal debt margin but must also conform to limitations on the general credit of the City. Voter approval is required to issue G.O. bonds.

The City will first pursue other options prior to considering an issuance of G.O. bonds.

**B. Revenue Bonds**

The City may issue bonds secured solely by dedicated revenue streams if doing so will yield clearly identifiable advantages. For the City to issue revenue bonds, a primary objective will be to minimize risk through the use of adequate coverage requirements while remaining in compliance with overall debt management policy objectives. The City will adhere and where necessary take actions to ensure compliance with all outstanding revenue bond covenants.

**C. Special Assessment Bonds**

The City shall maintain a watchful attitude over the issuance of special assessment bonds for benefit district improvements. While the City's share of any benefit district project may fluctuate, the City will not pay more than 50% of any proposed costs related to a benefit district. Further, each special assessment bond issue will be analyzed to ensure that future special assessments will equal or exceed the annual principal and interest payments of such bonds.

## **Financing Alternatives**

One of the primary decisions made regarding the Capital Improvements Plan (CIP) is whether to use cash on hand or debt financing. The parameters for this decision are defined below within each funding source that is considered appropriate.

### **Cash Funding**

City policy encourages funding capital projects with cash, on a "pay as you go" basis, to the extent possible and practical. As part of the pay-as-you-go strategy, the City will first look for grant and other restricted funding for capital projects. Cash funding is recommended under the following circumstances:

- To finance purchases of assets whose lives are shorter than five years
- To finance recurring maintenance expenditures (i.e., street repair vs. street construction)
- When market conditions are unstable or present difficulties in achieving acceptable interest rates.

### **Debt Financing**

It is prudent policy to use notes and bonds for capital asset funding under the parameters set forth below. No single parameter stands alone; they must all be considered under the current circumstances and in relation to the others. The parameters are as follows:

- Long-term bonds are recommended for projects with useful lives of ten years or longer.
- Special assessment debt funding is recommended for projects where the burden of payment rests more directly on a selected group of taxpayers or beneficiaries.

## **Capital Lease Debt**

The use of lease/purchase agreements in the acquisition of vehicles, equipment and other capital assets shall be considered carefully relative to any other financing option or a "pay-as-you-go" basis.

- Capital lease debt may be considered to finance capital improvements, including vehicles and equipment with an expected useful life of less than ten years. Principal and interest are to be paid from the operating budget or other dedicated resources of the department purchasing the equipment or constructing the capital improvement.
- Certificates of Participation (COPs) are a form of lease obligation in which the City enters into an agreement to pay a fixed amount annually to a third party, usually a nonprofit agency or a private leasing company or trust structure, subject to annual appropriation.

## **Low Interest Loan**

The use of federal and state aided low interest loans will be a valid financing mechanism and should be considered. This method of financing should be used wherever practical to fund a project. Some loans may have additional requirements that can be cost prohibitive.

## **Credit Enhancements**

Credit enhancement (letters of credit, bond insurance, etc.) may be used if the costs of such enhancements will reduce the net debt service payments on the bonds or provide other significant financial benefits to the City.

## **Variable Rate Debt**

The City shall not issue variable rate debt.

## **Selecting and Retention of Service Providers**

The Director of Financial Services shall be responsible for the solicitation and selection of professional services that are required to administer the City's debt program. Examples of those services include:

### **1. Bond Counsel**

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.

## 2. Financial Advisor

A Financial Advisor(s) will be used to assist in the issuance of the City's debt. The Financial Advisor will provide the City with objective advice and analysis on debt issuance. This includes, but is not limited to, monitoring market opportunities, structuring and pricing debt, and preparing official statements of disclosure.

## 3. Underwriters

An Underwriter(s) will be used for all debt issued in a negotiated or private placement sale method. The Underwriter is responsible for purchasing negotiated or private placement debt and reselling the debt to investors.

## Methods of Sale

Each of the three types of bond sales has the potential to provide the lowest cost given the right market conditions. The method of sale that is most advantageous to the City will be determined under consultation with the City's Financial Advisor. The three methods are:

- a. **Competitive Sale.** Bonds are marketed to a wide audience of investment banking (underwriting) firms. Their bids are submitted at a specified time. The underwriter is selected based on its bid for its securities. Pursuant to this policy, and within the parameters approved by the City Council, the Director of Financial Services is hereby authorized to sign the bid form on behalf of the City fixing the interest rates on bonds sold on a competitive basis.
- b. **Negotiated Sale.** The City selects the underwriter or group of underwriters of securities in advance of the bond sale. The City financing team works with the underwriter to bring the issue to the market and negotiates all rates and terms of the sale. In advance of the sale, the City will determine compensation for and liability of each underwriter employed and the designation rules and priority of orders under which the sale itself will be conducted (e.g., retail, group net, net designated, etc.). Pursuant to this policy and within the parameters approved by the City Council, the Director of Financial Services is hereby authorized to sign the bond purchase agreement on behalf of the City fixing the interest rates on bonds sold on a negotiated basis.
- c. **Private Placement.** The City sells its bonds to a limited number of sophisticated investors, and not the general public.

## Disclosure

The City will comply with the requirements of Rule 15c2-12 of the Securities and Exchange Commission (SEC), when applicable. The Director of Financial Services, or his/her designee, will be responsible for filing the annual requirements and any Material Event Notices with Electronic Municipal Market Access (EMMA) as required.

## **Debt Limits**

The City will fully comply with all debt limitations imposed by the Arizona Revised Statutes (A.R.S.).

## **Credit Ratings**

The City will maintain good communication with bond rating agencies about its financial condition. This effort will include providing periodic updates on the City's general financial condition in accordance with the bond rating agency requirements, coordinating meetings, and presentations in conjunction with a new issuance. The City will continually strive to maintain its bond rating by improving financial policies, budgets, forecasts, and the financial health of the City.

Credit enhancements may be used to improve or establish a credit rating on a City debt obligation. Credit enhancements should only be used if cost effective.

## **Defeasance, Prepayment and Refunding**

Annual reviews of all outstanding debt will be undertaken to determine refunding opportunities. Refunding will be considered (within federal tax law constraints) if and when there is a net economic benefit of the refunding or the refunding is essential in order to modernize covenants essential to operations and management.

City staff and the financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding debts. As a general rule, debt refundings will be undertaken only if the present value savings of a particular refunding will exceed 3% of the refunded principal.

Some refundings may be executed for reasons other than to achieve cost savings, such as to restructure the repayment schedule of the debt, to change the type of debt instruments being used, or to retire an indenture in order to remove undesirable covenants. Refunding issues with negative savings will not be considered unless a compelling public policy objective is served by the refunding.

## **Investments of Bond Proceeds**

The City shall comply with all applicable federal, state, and indenture restrictions, if any, regarding the use and investment of bond proceeds. This includes compliance with any restrictions on the types of investment securities allowed, restrictions on the allowable yield of invested funds, as well as restrictions on the time period over which some bond proceeds may be invested. The Director of Financial Services, or his/her designee, will direct the investment of bond proceeds in accordance with the permitted investments for each particular bond issue. Investments, such as guaranteed investment contracts, may be considered when their use is in the best interest of the City and will be selected on a competitive basis.

## **Federal Arbitrage and Rebate Compliance**

All the City's tax-exempt issues, including lease purchase agreements, are subject to arbitrage compliance regulations.

The City shall comply with all arbitrage rebate requirements as established by the Internal Revenue Service (IRS) and establish a system of recordkeeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code. This effort shall include tracking project expenditures financed with bond proceeds, tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the City's outstanding tax-exempt debt issues.

Arbitrage service providers maybe used to assist the City with complying with arbitrage regulations.

## **Issuance & Post-Issuance Compliance Procedures**

Staff will work closely with the City's Bond Counsel, Financial Advisor, and Arbitrage Compliance Specialist to ensure tax exempt bonds remain in compliance with federal tax requirements from the time they are issued until they are no longer outstanding.

## **Reporting**

The Financial Services Department is charged with the responsibility of preparing monthly financial reports. The monthly financial report will include a summary of the City's outstanding debt. If the City has any outstanding G.O. bonds, the monthly financial report will also include a calculation of the City's debt capacity.

On an annual basis, the Financial Services Department will prepare the state required Bonded Indebtedness Report in accordance with A.R.S. §35-501. This report must be filed even if the City has no bond indebtedness or lease/purchase data to report. If the City fails to comply, the City shall not issue any additional bonds or other securities. Furthermore, any person or member of any governing body knowingly omitting or refusing to comply with this request is guilty of a class 2 misdemeanor per A.R.S. §35-502.

The Financial Services Department will also be responsible for preparing all required debt related schedules and footnotes for inclusion in the City's comprehensive annual financial report.