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Revised Issue Date	SUBJECT: DEBT MANAGEMENT	Department of Origin Administrative Services

PURPOSE:

To establish a policy that complies with state law and provides guidance to City of Fullerton (City) staff as it relates to the administration of debt management and applicable fiscal resources.

AUTHORITY:

Effective January 1, 2017, Senate Bill (SB) 1029 required each public agency to adopt and have in effect a debt management policy prior to the issuance of debt obligations. The Fullerton City Council has the authority on behalf of itself and certain related entities to adopt a debt management policy in order to comply with SB 1029.

APPLICATION:

This policy shall apply to the issuance of debt by the City, the Successor Agency to the Fullerton Redevelopment Agency (Successor Agency), the City of Fullerton Public Financing Authority or any other public agency for which the Fullerton City Council acts as its legislative body.

POLICY:

This Debt Management Policy (Debt Policy) of the City was approved by the City Council on July 7, 2020. The Debt Policy may be amended by City Council as it deems appropriate from time to time in the prudent management of the debt of the City.

The Debt Policy has been developed to provide guidance in the issuance and management of debt by the City or its related entities and is intended to comply with Government Code Section 8855(i), as amended on September 12, 2016 and effective on January 1, 2017. 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 for its residents and businesses.

Approved for Distribution:

Kenneth A. Domer
City Manager

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1. Findings

This Debt Policy shall govern all debt undertaken by the City. The City hereby recognizes that a fiscally prudent debt policy is required in order to:

- Maintain the City's sound financial position.
- Ensure the City has the flexibility to respond to changes in future service priorities, revenue levels, and operating expenses.
- Protect the City's credit-worthiness.
- Ensure that all debt is structured in order to protect both current and future taxpayers, ratepayers and constituents of the City.
- Ensure that the City's debt is consistent with the City's planning goals and objectives and capital improvement program or budget, as applicable.
- Encourage those that benefit from a facility/improvement to pay the cost of that facility/improvement without the need for the expenditure of limited general fund resources.

2. Policies

A. Purposes For Which Debt May Be Issued

The City will consider the use of debt financing primarily for capital improvement projects (CIP) when the project's useful life will equal or exceed the term of the financing and when resources are identified sufficient to fund the debt service requirements. An exception to this CIP driven focus is the issuance of short-term instruments such as tax and revenue anticipation notes, which are to be used for prudent cash management purposes and conduit financing, as described below. 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 City Manager and the Director of Administrative Services with reasonable cost estimates, including specific revenue accounts that will provide payment for the debt service. This will allow an analysis of the project's potential impact on the City's debt capacity and limitations. The department director shall also provide an estimate of any incremental operating and/or additional maintenance costs associated with the project and identify sources of revenue, if any, to pay for such incremental costs.

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(i) Long-Term Debt. Long-term debt may be issued to finance or refinance the construction, acquisition, and rehabilitation of capital improvements and facilities, equipment and land to be owned and/or operated by the City.

(a) Long-term debt financings are appropriate when the following conditions exist:

- When the project to be financed is necessary to provide basic services or to fulfill the City's authorized or legal obligations.
- When the project to be financed will provide a benefit to constituents over multiple years.
- When total debt does not constitute an unreasonable burden to the City and its taxpayers and ratepayers.
- When the debt is used to refinance outstanding debt in order to produce debt service savings or to realize the benefits of a debt restructuring.

(b) Long-term debt financings will not generally be considered appropriate for current operating expenses and routine maintenance expenses.

(c) The City may use long-term debt financings subject to the following conditions:

- The project to be financed has been or will be approved by the City Council.
- The weighted average maturity of the debt (or the portion of the debt allocated to the project) will not exceed the average useful life of the project to be financed by more than 20%, unless specific conditions exist that would mitigate the extension of time to repay the debt and it would not cause the City to violate any covenants to maintain the tax-exempt status of such debt, if applicable.
- The City estimates that sufficient income or revenues will be available to service the debt through its maturity.
- The City determines that the issuance of the debt will comply with the applicable requirements of state and federal law.
- The City considers the improvement/facility to be of vital, time-sensitive need of the community and there are no plausible alternative financing sources.

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(d) Periodic reviews of outstanding long-term debt will be undertaken to identify refunding opportunities. Refundings will be considered (within federal tax law constraints, if applicable) if and when there is a net economic benefit of the refunding. Refundings, which are non-economic, may only be undertaken to achieve other City objectives relating to changes in covenants, call provisions, operational flexibility, tax status of the issuer, or the debt service profile.

- (ii) Short-term debt. Short-term borrowings may be issued to generate funding for cash flow needs in the form of Tax and Revenue Anticipation Notes.

Short-term borrowings, such as commercial paper, and lines of credit, will be considered as an interim source of funding in anticipation of a long-term borrowing. Short-term debt may be issued for any purpose for which long-term debt may be issued, including capitalized interest and other financing-related costs. Prior to issuance of the short-term debt, a reliable revenue source shall be identified to secure repayment of the debt. The final maturity of the debt issued to finance the project shall be consistent with the economic or useful life of the project and, unless the City Council determines that extraordinary circumstances exist, must not exceed seven (7) years.

Short-term debt may also be used to finance short-lived capital projects; for example, the City may undertake lease-purchase financing for equipment, and such equipment leases may be longer than seven (7) years.

- (iii) Financings on Behalf of Other Entities. The City may also find it beneficial to issue debt on behalf of other governmental agencies or private third parties in order to further the public purposes of the City. In such cases, the City shall take reasonable steps to confirm the financial feasibility of the project to be financed and the financial solvency of any borrower and that the issuance of such debt is consistent with the policies set forth herein. In no event will the City incur any liability or assume responsibility for payment of debt service on such debt.

B. Types of Debt

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

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- General Obligation (GO) Bonds: GO 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 shall be authorized by the requisite number of voters in order to pass.
- Revenue Bonds: Revenue Bonds are limited liability obligations tied to a specific enterprise or special fund revenue stream where the projects financed clearly benefit or relate to the enterprise or are otherwise permissible uses of the special revenue. An example of projects that would be financed by a Revenue Bond would be improvements to a water system, which would be paid back with money raised from the rates and charges to water users. Generally, no voter approval is required to issue this type of obligation but in some cases, the City must comply with proposition 218 regarding rate adjustments.
- Lease-Backed Debt/Certificates of Participation ("LRBs/COPs"): Issuance of LRBs/COPs are a commonly used form of debt that allows a City to finance projects where the debt service is secured via a lease agreement and where the payments are budgeted in the annual budget appropriation by the City from the general fund. LRBs/COPs do not constitute indebtedness under the state or the City's constitutional debt limit and does not require voter approval. LRBs/COPs may be issued by the Fullerton Public Financing Authority on behalf of the City.
- Special Assessment/Special Tax 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 the City Council, which may include minimum value-to-lien ratios and maximum tax burdens. Examples of this type of debt are Assessment Districts and Community Facilities Districts sometimes referred to as Mello-Roos Districts. In order to protect bondholders as well as the City's credit rating, the City will also comply with all State guidelines regarding the issuance of special tax district or special assessment debt, as well as any policy required to be adopted under Government Code Section 53312.7.
- Tax Allocation Bonds: Tax Allocation Bonds are special obligations that are secured by the allocation of tax increment revenues that are generated by increased property taxes in a designated redevelopment project 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 amended, the Dissolution Act) as codified in the California Health and

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Safety Code, the Fullerton 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 Successor Agency. The Successor Agency may issue Tax Allocation Bonds to refinance outstanding obligations of the RDA, subject to limitations included in the Dissolution Act.

- Multi-Family Mortgage Revenue Bonds: The City is authorized to issue mortgage revenue bonds to finance the development, acquisition and rehabilitation of multi-family rental projects. The interest on the bonds may be exempt from Federal and State taxation. As a result, the bonds may 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.
- 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.

The City may from time to time find that other forms of debt would be beneficial to further its public purposes and may approve such debt without an amendment of this Debt Policy.

To maintain a predictable debt service burden, the City will give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is variable rate debt. The City may choose to issue securities that pay a rate of interest that varies according to a pre-determined formula or results from a periodic remarketing of securities. When making the determination to issue bonds in a variable rate mode, consideration will be given with regards to the useful life of the project or facility being financed or the term of the project requiring the funding, market conditions, credit risk and third party risk analysis, and the overall debt portfolio structure when issuing variable rate debt for any purpose. The maximum amount of variable-rate debt as a percentage of the total debt portfolio should be determined upon assessment and review with the City's municipal advisor.

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The City will not employ derivatives, such as interest rate swaps, in its debt program. A derivative product is a financial instrument, which derives its own value from the value of another instrument, usually an underlying asset such as a stock, bond, or an underlying reference such as an interest rate. Derivatives are commonly used as hedging devices in managing interest rate risk and thereby reducing borrowing costs. However, these products bear certain risks not associated with standard debt instruments.

C. Relationship of Debt to Capital Improvement Program and Budget

The City intends to only issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the City's capital budget and the CIP.

The City shall strive to fund the upkeep and maintenance of its infrastructure and facilities due to normal wear and tear through the expenditure of available operating revenues. The City shall seek to avoid the use of debt to fund infrastructure and facilities improvements that are the result of normal wear and tear, unless a specific revenue source has been identified for this purpose, such as Gas Tax funds.

The City shall integrate its debt issuances with the goals of its capital improvement program by timing the issuance of debt to ensure that projects are available when needed in furtherance of the City's public purposes.

The City shall seek to issue debt in a timely manner to avoid having to make unplanned expenditures for capital improvements or equipment from its general fund.

D. Policy Goals Related to Planning Goals and Objectives

The City is committed to financial planning, maintaining appropriate reserves levels and employing prudent practices in governance, management and budget administration. The City intends to issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the City's annual operating budget.

It is a policy goal of the City to protect taxpayers, ratepayers and constituents by utilizing conservative financing methods and techniques so as to obtain the highest practical credit ratings (if applicable) and the lowest practical borrowing costs.

The City will comply with applicable state and federal law as it pertains to the

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maximum term of debt and the procedures for levying and imposing any related taxes, assessments, rates and charges.

Except as described in Section 2.A., when refinancing debt, it shall be the policy goal of the City to realize, whenever possible, and subject to any overriding non-financial policy considerations minimum net present value debt service savings equal to or greater than 4% of the refunded principal amount.

E. Internal Control Procedures

When issuing debt, in addition to complying with the terms of this Debt Policy, the City shall comply with any other applicable policies regarding initial bond disclosure, continuing disclosure, post-issuance compliance, and investment of bond proceeds.

The City will periodically review the requirements of and will remain in compliance with the following:

- Any continuing disclosure undertakings under SEC Rule 15c2-12;
- Any federal tax compliance requirements, including without limitation arbitrage and rebate compliance, related to any prior bond issues; and
- The City's investment policies as they relate to the investment of bond proceeds.

Whenever reasonably possible, proceeds of debt will be held by a third-party trustee and the City will submit written requisitions for such proceeds. The City will submit a requisition only after obtaining the signature of the City Manager, the Director of Administrative Services or their designee.

F. Waivers of Debt Policy

There may be circumstances from time to time when strict adherence to a provision of this Debt Policy is not possible or in the best interests of the City and the failure of a debt financing to comply with one or more provisions of this Debt Policy shall in no way affect the validity of any debt issued by the City in accordance with applicable laws.