OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Proposed Changes to the City's Debt Policy

OVERVIEW

The City Council adopted the City's Debt Policy (Policy) on November 6, 2007. The Policy documents the City's procedures and goals for the use of debt to finance the City's needs. As noted in the Overview section of the Policy, "debt" primarily refers to debt instruments/securities issued by the City in public or private bond markets.

In adopting the Policy, the City Council requested that proposed additions and/or revisions to the Policy be brought back to Council annually for review. The Council further requested that the Policy update be accompanied by a discussion of developments in the financial markets, the City's anticipated financing calendar and a debt profile of the City and its related entities. The Policy was last reviewed on October 27, 2008. Proposed changes to the Policy for 2009 were presented to the Budget and Finance Committee on December 2, 2009. This report briefly comments on the proposed revisions to the Policy in 2009.

FISCAL/POLICY DISCUSSION

The Government Finance Officers Association (GFOA) recommends that cities develop formal debt policies to establish parameters and to provide general direction in the planning and implementation of a debt program. The City adopted a comprehensive Debt Policy in 2007. In the GFOA's Elected Official's Guide to Debt Issuance, it is further recommended that debt policies be 1) reviewed at least annually and revised as necessary and 2) formally submitted to and adopted by a jurisdiction's elected officials. The City immediately began adhering to these recommendations with the City Council's review and adoption of the Policy in 2007 and proposed amendments to the Policy in 2008.

Proposed Policy Changes in 2009

Proposed Policy revisions have been highlighted and notated in the draft Policy for 2009 that has been docketed for review. The IBA briefly comments on each of the substantive changes below:

Section 3.15 - State Revolving Funds (pages 11-12)

The State Revolving Fund (SRF) provides low interest loans for the construction of water and wastewater infrastructure projects. In the past, SRF loans have been structured to create an effective interest rate of approximately 2%. Beginning in March 2009, the rate for new SRF loans is calculated by taking the True Interest Cost (TIC) of the most recent State of California General Obligation Bond sale and dividing that rate in half. The proposed Policy revision reflects the change in the rate of interest for SRF loans.

Based on a TIC of 5.78% for State General Obligation Bonds sold in November 2009, a SRF loan issued today would be made at approximately 2.89%. Level annual principal and interest payments would typically be required to be repay SRF loans, usually over a 20-year term. As the rate of interest on SRF loans is likely to remain significantly lower than other available financing alternatives, SRF loans (when available) provide an attractive borrowing option for City water and wastewater infrastructure projects.

Section 4.3 - Coverage Targets for Revenue Bonds (page 14)

There are two proposed revisions to this section. The first revision removes the reference to redevelopment debt in this section of the policy. In September 2007, the Budget and Finance Committee requested that a separate policy for Redevelopment Agency debt issuances be developed for inclusion as an appendix to the Policy. As the Policy currently does not cover Redevelopment Agency debt, the IBA continues to recommend that a redevelopment debt policy be developed to provide guidelines and parameters for the issuance of redevelopment debt.

The second revision clarifies the legal debt service coverage ratio requirements set forth in the bond documents for the City's outstanding Water and Wastewater Revenue Bonds. The proposed revision further clarifies that, in accordance with rating agency guidelines, the City will strive to maintain a 110% debt service coverage ratio on subordinated debt that only legally requires 100% coverage.

Section 9.3 - Ongoing Disclosure (page 26)

Securities and Exchange Commission (SEC) Rule 15c2-12 mandates when the disclosure of information related to municipal securities is to be made and where such information must be sent. The SEC amended Rule 15c2-12 (effective July 1, 2009) to require that disclosure information be provided to the Municipal Securities Rulemaking Board's (MSRB's) Electronic Municipal Market Access (EMMA) system instead of to Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) as was previously required. MSRB's EMMA system is now the sole repository for continuing disclosure filings. The proposed revision to this section of the Policy reflects the new SEC requirement.

Appendix A - Special District Formation and Financing Policy (page 29)

Special district financing (Community Facilities Districts and 1913/1915 Act Assessment Districts) typically provides developers with a low interest rate means of financing public infrastructure associated with their development projects. City staff time associated with facilitating the formation of these districts and administering the resulting debt over the life of the bonds can be considerable. Although the City recovers 100% of associated staff and consultant costs from developer deposits and ultimately property assessments/special taxes, special district financing can occasionally divert limited staff resources from other core City financing priorities.

In order to accommodate private special district financing requests, prioritize the work of Debt Management Department staff when/if workload demands exceed staff capacity and provide the City with another special district financing option, the CFO is proposing to amend the Policy to provide the City with the flexibility to utilize State joint powers authorities (JPAs) to facilitate the formation of special districts and the ensuing issuance/administration of special district debt. The City Council would still be required to adopt a resolution in advance 1) authorizing a JPA to form the district and issue/administer debt and 2) approving the City's public infrastructure acquisition agreement.

The IBA understands and supports the CFO's interest in building this flexibility into the Policy; however, as this would represent a new approach for the City and for certain State JPAs, the IBA raises the following questions/comments for further consideration in deciding whether to exercise this new option, if adopted:

- Will special district formation, debt issuance and annual administration costs for property owners be different (higher or lower) or the same if JPAs are utilized?

- Can JPAs form and administer special districts adhering to all of the parameters established within the City's Special District Formation and Financing Policy?

- Will the City be able to, or ever need to, intervene in the future on behalf of City property owners with a special district concern (e.g., a disputed assessment/special tax amount or a bond required property foreclosure action) if a JPA has formed and administers the district?

- If there are multiple special district financing requests that exceed Debt Management Department staff capacity, should the City's Policy provide guidelines for determining which requests are recommended for JPA facilitation?

Appendix A - Special Districts Policy: A3 - Eligible Facilities and Priorities (pages 33-34)

This proposed amendment to the Policy allows for a broader definition of eligible facilities, to include certain private facilities (i.e., energy or water efficiency improvements), in accordance with State law and Charter City authority. As the potential uses for special district financing continues to evolve for local government, the IBA supports an expanded definition of eligible facilities in the Policy.

CONCLUSION

As summarized in this report, the IBA has reviewed and supports the proposed changes to the City's Debt Policy for 2009. We continue to recommend that the Council's request for a separate policy for Redevelopment Agency debt be developed for inclusion as an appendix to the Policy. Additionally, we have suggested that requested Policy flexibility to transfer responsibility for special district formation and debt issuance/administration from the City to JPAs may benefit from additional analysis prior to a CFO recommendation for the utilization of this option.

[SIGNED]

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