

MENDOCINO COUNTY POLICY #48	DEBT MANAGEMENT POLICY
ADOPTED: April 24, 2012	ADOPTED BY: Minute Order

Debt Policy Objective

The objective of the Debt Management Policy (“the Policy”) is to establish guidelines addressing long-term capital improvement costs, short-term and long-term cash management and to create policies and procedures that minimize Mendocino County’s (“the County”) debt service and issuance cost. The primary objective is to ensure prudent debt management practices which maintain financial stability, preserve public trust and minimize costs to taxpayers.

Additional objectives are as follows:

- Long-term Debt shall not be used to finance ongoing operational costs.
- Whenever possible, the County shall pursue alternative sources of funding, such as pay-as-you-go or grant funding, in order to minimize the level of direct debt.
- Whenever possible, the County shall use special assessment, revenue or other self-supporting Debt instead of General Fund obligated Debt.
- Any Debt issued shall not have a maturity date beyond the useful life of the asset being acquired or constructed by the Debt proceeds.
- The County shall establish an affordable debt level in order to preserve credit quality and ensure sufficient revenue is available to pay annual Debt Service.

Debt Policy Overview

The County’s overriding goal in incurring long-term financial obligations is to respond to the evolving needs of its citizens while maintaining its fiscal responsibilities. This Policy documents the County’s goals for the use of debt instruments and provides guidelines for the use of debt for financing County needs.

Although long term financing sometimes requires higher total expenditures than a cash purchase, it has the benefit of allowing immediate completion of the project so that those paying for the project are also those utilizing the project. Additionally, during times of rapidly increasing construction costs, the costs related to financing a project are sometimes less than construction cost increases caused by delaying the project until adequate cash is available.

The County’s Debt Management Policy is designed to:

- Establish guidelines for the use of debt financing;
- Provide guidance to decision makers related to debt affordability standards;
- Promote objectivity in the decision-making process; and
- Facilitate the actual financing process by establishing important policy decisions in advance.

An important goal for the County is to maximize the County’s credit ratings as issued by the primary bond rating services: Fitch, Moody’s and Standard and Poor’s. Lower credit ratings will severely limit the County’s ability to obtain financing and increase the borrowing costs substantially once limited financing opportunities are attained.

The County will also seek to minimize borrowing costs by taking advantage of favorable economic conditions. Timing debt issuance to accommodate market interest rates and investor sentiment is an important means of minimizing the cost of debt and the tax burden on the citizens of the County. To accomplish this, the County will seek input on market conditions from financial consultants who closely monitor the financial markets.

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The debt policies and practices of the County are, in every case, subject to and limited by applicable provisions of state and federal law. The County will adhere to the following legal requirements for the issuance of public debt:

- The state law, which authorizes the issuance of the debt;
- The federal and state tax laws, which govern the eligibility of the debt for tax-exempt status;
- The federal and state securities laws governing disclosure, sale and trading of the debt.

DEBT ADVISORY COMMITTEE

A. Committee Structure

All proposed debt financings shall be presented to the Debt Advisory Committee (“the Committee”) for review and recommendation and must be approved by the Board of Supervisors. The committee shall be comprised of the following:

- Chief Executive Officer (Chair)
- County Treasurer (Vice-Chair)
- County Auditor
- Assistant County Auditor
- Deputy Chief Executive Officer – Chief Budget Officer
- County Counsel (non-voting)

County Counsel, a non-voting member of the Committee, will act as the Committee’s legal counsel and provide legal advice. The Chief Executive Officer (“CEO”), or his/her written designee, is a voting member and is responsible for setting and distributing the agenda and chairing the meetings.

B. Committee Purpose

The Committee shall:

- Oversee the issuance of all County debt;
- Periodically review and evaluate existing County debt;
- Periodically review, revise and/or amend the existing County Debt Management Policy as needed (revisions must be approved by the Board of Supervisors);
- Review all internal financing requests and unsolicited financing proposals to ensure they comply with the Policy; document and justify any recommended exceptions;
- Make appropriate recommendations to the Board of Supervisors;
- Ensure all covenants and continuing disclosure requirements are met on each existing debt issue.

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C. Meetings

1. Regular meetings shall be held quarterly and may be scheduled more often as needed.
2. Notwithstanding the foregoing, no official act of the Committee shall be valid unless at least three (3) of the voting members concur therein, and at least four (4) voting members are in attendance.

D. Ethics and Conflict of Interest

Committee members involved in the debt management program will not engage in any personal business activities that could conflict with proper and lawful execution of the debt management program, or which might impair their ability to make impartial decisions.

DEBT MANAGEMENT

A. Debt Review and Recommendations

1. Each proposed financing brought before the Committee will include a feasibility study that provides the following information on a "Proposed Financing" form (see **Appendix A**):
 - A detailed description of the type and structure of the financing, including any type of accompanying derivative or investment products;
 - Full disclosure of the specific use of the proceeds and justification for borrowing as opposed to "pay-as-you-go";
 - A description of the public benefit to be provided by the project or proposal;
 - The principal parties involved in the transaction;
 - Anticipated sources of repayment;
 - An estimated Sources and Uses statement;
 - Any credit enhancements proposed;
 - The anticipated debt rating, if any;
 - An estimated debt service schedule and how it compares to the asset life;
 - An analysis of the County's debt ratios after the completion of the financing, pursuant to established guidelines.
2. Dissension - When any vote of the members is not unanimous, a report outlining the dissenting opinion(s) will be prepared by the Chair, in consultation with the dissenter(s); said report will accompany the recommendation made to the Board.
3. The Committee may retain a qualified Financial Advisor at their discretion, provided no County funds are expended without prior Board approval.

B. Monitoring of Existing Debt

It is the task of this committee to assess the County's ability to generate and repay debt. The committee will issue an annual report to the Board of Supervisors discussing the County's debt burden. This review will be an important element of the budget process and will include recommendations about the advisability of incurring additional debt when new debt is proposed.

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C. Refinancing of Outstanding Debt

The County may refinance outstanding debt under the following circumstances:

1. Debt Service Savings. The County may refinance outstanding long-term debt when such refinancing allows the County to realize significant present value debt service savings (minimum present value savings shall be at least 3.00%) without lengthening the term of refinanced debt and without increasing debt service in any subsequent fiscal year. The County may also consider debt refinancing when a primary objective would be the elimination of restrictive covenants that limit County operations.
2. Defeasance. The County may refinance outstanding debt, either by advance refunding to the first call or by defeasance to maturity, when the public policy benefits of replacing such debt outweigh the costs associated with new issuance as well as any increase in annual debt service.

D. Credit Ratings

The County seeks to maintain the highest possible credit ratings for all categories of short and long-term obligations that can be achieved without compromising delivery of basic County services and achievement of County policy objectives. The County recognizes that external economic, natural or other events may from time to time affect the creditworthiness of its debt. Nevertheless, the County is committed to ensuring that actions within its control are prudent. Accordingly, each proposal for additional debt will be analyzed for its impact on the County's credit rating.

An Underwriter or Financial Consultant may recommend obtaining a credit rating on a particular financing; the Chief Executive Officer, or a designee of the Committee, is responsible for authorization to secure the services of one of more major credit rating agencies and maintaining relationships with the rating agencies that assign ratings to the County's various debt obligations.

The County's minimum rating requirement for its direct, long-term, debt obligations is a rating of "investment grade" or higher. If such a debt obligation cannot meet this requirement, based on its underlying credit strength, then credit enhancement shall be sought to ensure that an appropriate rating is achieved. Obligations whose ratings would fall below the minimum rating requirement may be issued without a rating, if credit enhancement is unavailable or if the Committee determines that the benefit of credit enhancement is not cost effective.

E. Financial Disclosure

To assure clear, comprehensive, and accurate financial information, the County is committed to meeting secondary disclosure requirements on a timely and comprehensive basis, cooperating fully with rating agencies, institutional and individual investors, County departments and agencies, other levels of government and the general public.

Official statements accompanying debt issues, financial reports and continuous disclosure statements will meet, at a minimum, the standards articulated by the Government Accounting Standards Board (GASB), the Securities and Exchange Commission (SEC) and the Generally Accepted Accounting Principles (GAAP).

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F. Credit Issuance Guidelines

The County will conform to State Statutes, Federal Tax and Securities Regulations and will issue debt at levels consistent with its creditworthiness objectives. When applicable, rating agency medians may be compared by using one or more of the following ratios:

- Debt per capita
- Debt as a percent of taxable value
- Debt service payments as a percent of current revenues and current expenditures
- The level of overlapping net debt of all local taxing jurisdictions

In assessing affordability, the County shall also examine the direct costs and benefits of the proposed project. The decision of whether or not to assume new debt shall be based on these costs and benefits, current conditions of the municipal bond market, and the County's ability to "afford" new debt as determined by the aforementioned measurements. The County shall strive to achieve and/or maintain these standards at a low to moderate classification.

FINANCING OPTIONS

Purpose of Debt

The County may issue debt for either new money or refunding purposes; there are many different types of financing instruments available. The County's selection among available financing instruments depends on legal constraints, investor demand, capital market activity and the type of project being financed. **Appendix B** contains a brief description of financing options, representative but not all-inclusive, available for consideration once the County decides debt issuance is the appropriate funding vehicle.

Short-Term Debt

The County may use short-term obligations (i.e. with final maturities of thirteen months or less) as a cash management tool to provide interim financing and/or to bridge temporary cash flow deficits within a fiscal year.

For example, the County often issues Tax and Revenue Anticipation Notes ("TRANS"). TRANS are appropriately used to fund cash flow deficits in a fiscal year. TRANS proceeds may be used and expended for any purpose, including current operating expense, capital expenditure, repayment of indebtedness, investment and reinvestment.

Long-Term Debt

Long-term obligations (i.e. with final maturities greater than thirteen months) are preferred for financing essential capital activities including the acquisition, construction and rehabilitation of major capital assets or to fund other special programs, such as self-insurance, worker's compensation insurance and unfunded pension liability. The County may also use long-term lease obligations to finance or refinance capital equipment or facilities. Prior to entering into any lease financing, the County will evaluate (1) the useful life of assets financed, (2) terms and conditions of the lease and (3) budgetary, debt capacity and tax implications.

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For example, the County may issue Certificates of Participation (“COPs”) to finance acquisition of equipment or construction of a facility. COPs are a form of lease obligation in which the County enters into an agreement to pay a fixed amount annually to a third party, usually a nonprofit agency or a private leasing company. COPs do not require voter approval, and they do not count towards a jurisdiction’s debt volume limitations. Payments are subject to annual appropriations.

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APPENDIX A

Proposed Financing

Complete Page 1 (below) and forward to CEO, Treasurer-Tax Collector and Auditor-Controller for analysis and referral to the Debt Advisory Committee

Project Title: _____

Date of Request: _____ Date Project Commences: _____

Requesting Department: _____ Contact Person(s): _____

Budget Unit: _____ Phone Number(s): _____

FAX Number(s): _____

Amount Requested: \$ _____ Email Address(s): _____

(Attach additional sheet if more than two contacts)

Project Description:

Source of Repayment:

Justification:

(Detailed cost/benefit analysis, use of proceeds, justification for borrowing vs. "pay as you go," public benefit, grants or department funds contribution to project, usable life of project, etc.)

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Pending proposed financings (5 year horizon):

<u>Year Needed</u>	<u>Amt. to be Financed</u>	<u>Source of Repayment</u>	<u>Project Description</u>

Attach additional pages and/or supporting documentation as needed

When completed, send:

- 1 copy to CEO
- 1 copy to Treasurer-Tax Collector
- 1 copy to Auditor-Controller

ANALYSIS:

Amount of Financing: _____

Type and Structure of Debt: _____

Estimated Annual Debt Service: _____ General Fund Debt? YES NO

Tax-Exempt Taxable Term (Yrs) _____

Estimated All-In True Interest Cost: _____

Ratio of Annual Debt Service/GF Revenues: 1 Year: _____ 5 Year Fwd Avg: _____
Guideline is 5% - 7% (10% max)

Estimated Credit Rating: _____ Credit Enhancement recommended? YES NO

(For information only):

Overall Debt as % of Property Valuations: _____ (≤ 2% recommended)

Unreserved/Undesignated General Fund Balance as % of GF Revenues: _____
(8-10% recommended)

Submit copies of analysis with supporting documentation to CEO for distribution to all Committee members.

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Debt Advisory Committee Recommendation:

Vote Count: APPROVE __ MODIFY __ DENY __ ABSTAIN __ ABSENT __

Comments:

Dissenting Opinion(s) as applicable; attach additional documentation if needed:

Recommended Financing Team

Bond Counsel: _____ Trustee: _____

Underwriter: _____ Pricing Agent: _____

Financial Advisor: _____ Other: _____

Negotiated or Competitive Pricing Recommendation/Justification: _____

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APPENDIX B

Definition of Terms

FINANCING OPTIONS

Non-Restrictive Debt

Long-term obligations payable solely from specific pledge sources, in general, are not subject to a debt limitation. Examples of non-restrictive debt include those which achieve the financing or refinancing of projects provided by the issuance of debt instruments that are payable from restricted revenues or user fees (Enterprise Funds), revenues generated from a project, special assessment districts, and tax collected from within a redevelopment project area in which the increase in assessed valuation has resulted from redevelopment. In addition, these long-term obligations do not constitute obligations with a claim against any other resources of the government, if the pledged sources are insufficient. Taxes levied in regards to the formation of special assessment districts and special taxes, however, must be approved by two-thirds of the voters within the district.

General Obligation Bonds (GO Bonds)

General Obligation Bonds, also known as "Full Faith and Credit" bonds, are secured by all of the general fund revenues of the County. They carry the County's commitment to increase taxes if necessary to repay the debt. Debt service on the bonds is provided from ad valorem taxes on real property within the County. GO Bonds usually achieve lower rates of interest than other financing instruments since they are considered to be a lower risk. Additionally, they are usually limited by state law as to the amount and term.

Revenue Bonds

Revenue bonds may be issued by Enterprises to finance capital projects. The enterprises do not have taxing authority but may sell bonds which are repaid through restricted revenues and user fees. When appropriate, self-supporting revenue bonds shall be issued before general obligation bonds. The revenues generated must be sufficient to cover the debt repayment and interest. As a planning target, estimated revenues will be required to be maintained at 150% of the maximum annual debt service. The County will make annual adjustments to any rate structure relating to revenues pledged to a bond issue, if necessary, to maintain a 150% coverage factor. The Revenue Bonds will not be secured by any pledge of ad valorem taxes. When capital projects are financed by issuing revenue bonds, the term of the bonds will not exceed the expected life of those projects. The issuance of revenue bonds requires Board of Supervisor approval but does not require voter approval.

Certificates of Participation (COPs)

The Certificate of Participation is a widely used type of debt instrument that allows the County to finance capital projects/public facilities/equipment where the COP holders are repaid principal and interest through revenues generated from the project or by the County's agreement to lease the facilities or equipment. Debt service on a COP is subject to annual appropriation by the County. For COPs issued in connection with the financing of certain equipment purchases or other assets, the interest and principal repayment is budgeted in each year's operating budget until the obligation is repaid. Any County-owned and operated multi-use facility improvement

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can be financed with a COP. Specific assets, lease or installment agreements, as well as operating revenues, may be pledged to guarantee payment of the Certificates. Upon repayment of the COP, title to the asset is transferred to the County. COPs do not constitute indebtedness under the State or County's constitutional debt limit and do not require voter approval.

Special District Tax Bonds

Special District Tax Bonds are limited obligations payable solely from special tax revenues and funds pledged under the fiscal agent agreement. Neither the "full faith and credit" of the County nor the State of California or any political subdivision is pledged to the payment of the bonds. Development-supported financings include Community Facilities Districts (CFDs) and Mello-Roos Bonds.

Pursuant to law, the Board of Supervisors is authorized to establish a community facilities district or Mello-Roos district and act as the legislative body for the proposed district. The County may issue bonds and may levy and collect a special tax within such district to repay such indebtedness, if two-thirds of the registered voters in the district approve the tax.

Joint Venture Arrangements with Other Governmental Agencies

When a project serves the public interest beyond County boundaries, the County seeks out joint arrangements where other governmental bodies share the debt burden. Joint Venture debt is repaid through revenues generated by the project. The County will only be liable for its share of debt service, as specified by contract. All capital requests will explore the interaction and funding potential with other government agencies. If potential does exist, then the possibility for grants or cost sharing will be explored, quantified, and specific financial arrangements and liabilities negotiated.

Special Assessment Bonds

Special Assessment Districts are legally designated geographic areas located within the County, which, through the consent of the affected property owners, pay for basic infrastructure and public improvement to the area through a supplemental assessment. Bonds issued for financing projects of the district are repaid by special assessments of the property owners. This financing approach achieves the objective of tying the repayment of debt to those property owners who directly benefit from the improvements financed.

Tax and Revenue Anticipation Notes (TRANS)

The County may choose to issue Tax and Revenue Anticipation Notes to fund internal working capital cash flow needs, if such notes are judged to be prudent and advantageous to the County. TRANS are short-term notes that are issued, in part, to finance the County's Operating General Fund cash flow requirements during the fiscal year. The proceeds from the sale of the TRANS allow the County to cover periods of cash shortfalls resulting from a mismatch between timing of revenues and timing of expenditures. County expenditures tend to occur in relatively level amounts throughout the year, while receipts follow an uneven pattern. As tax payments and other revenues are received, they are used in part to retire the TRANS. Before issuing such notes, cash flow projections will be prepared by the Auditor-Controller.

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Lines and Letters of Credit

Where their use is judged by the Committee to be prudent and advantageous to the County, and with approval of the Board of Supervisors, the County has the power to enter into agreements with commercial banks or other financial entities for purposes of acquiring lines or letters of credit that shall provide the County with access to credit under terms and conditions as specified in such agreements, and/or to provide a liquidity facility or credit enhancement to the County's variable rate debt issues. Before entering into any such agreements, financing for such lines or letters of credit must be planned for and determined to be feasible.

Bond Anticipation Notes

Where their use is judged to be prudent and advantageous, the County may choose to issue Bond Anticipation Notes as a source of interim construction financing. Before issuing such notes, financing for such notes must be planned for and determined to be feasible.

Multifamily Housing Revenue Bonds and Single Family Housing Revenue Bonds

Typically, Housing Revenue Bonds are development-supported bonds where debt service is paid out of the project's revenues and guaranteed by the developer and third-party insurance companies. The County may choose to issue these tax-exempt housing bonds to help finance housing projects and build low-income housing units (typically 20% of the total residential units) within the project. Neither the "full faith and credit" of the County nor the State of California or any political subdivision is pledged to the payment of credit of the bonds.

Term Bonds, Serial Bonds and Capital Appreciation Bonds (CABs)

Serial bonds are bonds maturing annually (or serially) in specified amounts. Term bonds are those where all bonds, or a portion of the issue equal to that which would mature over a period of two or more years in a serial issue, mature at a single time. Term bonds can be structured so that a portion of term maturity is mandatorily called or retired each year (called "sinking") to mirror a serial bond structure. Capital Appreciation Bonds are deep discounted bonds that pay investors the face value of the bonds upon maturing. CABs will be utilized in certain cases to better manage a project's cash flow to the bond's debt service. The decision to use term, serial or CAB bonds is typically driven by bond marketing conditions. Specifically, if there is strong demand or weak demand for a particular bond maturity, the underwriter may combine two or more year's serial maturities as a term bond to take advantage of the strong demand or avoid the weak demand.