





TOWN OF FAIRFAX

STAFF REPORT

July 18, 2018

TO: Mayor and Town Council

FROM: Garrett Toy, Town Manager 
Michael Vivrette, Finance Director 
Janet Garvin, Treasurer

SUBJECT: Adopt a Resolution Amending the Debt Management Financial Policies

RECOMMENDATION

Adopt a resolution amending the Debt Management Financial Policies.

DISCUSSION

The Town last amended its Debt Management Financial Policies on August 2, 2017, to incorporate changes to state law. At that same meeting, the Council approved its responses to the Marin County Civil Grand Jury Report: "Marin's Retirement Health Care Benefits". The Grand Jury report requested each agency to adopt a formal, written policy for annual contributions to its Other Postemployment Benefits (OPEB) plan. While the Town responded that its informal policy is to fully fund its annual OPEB contributions, we agreed to adopt a formal, written policy.

The Finance Committee, consisting of Mayor Lacques, Vice-Mayor Coler, and Town Treasurer Janet Garvin and staff, reviewed the OPEB policy at their June 2018 meeting and recommends the following language be inserted into the Town's Financial Policies, Section 8 "Debt Management Policies."

Long-term Debt/OPEB:

1. Other Postemployment Benefits (OPEB) provide eligible retired employees of the Town of Fairfax with retiree health care benefits. The Town will prepare bi-annual actuarial reports to determine the Town's Annual Required Contribution (ARC) toward OPEB. The Governmental Accounting Standards Board (GASB) has released GASB 75 as a required standard for determining OPEB accounting, beginning with the 2017-18 fiscal year. Under GASB 75, an Actuarially Determined Contribution (ADC) replaces the ARC.
2. Since 2010, the Town has met its required ARC and has, at times, prefunded OPEB accrued liabilities. It is the Town's policy to continue to pay the Actuarially Determined Contribution per GASB 75 and, based on availability of resources, consider annually pre-funding its OPEB unfunded liabilities. The Town budgets for the ADC payment in each fiscal year budget.

ATTACHMENTS

- A. Financial Policies – redline, Section 8
- B. Resolution with Exhibit "A" Debt Management Financial Policies

FINANCIAL POLICIES

8. DEBT MANAGEMENT POLICIES

With the exception of funding for prudent cash flow needs in the form of Tax and Revenue Anticipation Notes (TRAN), a ratio of current assets to current liabilities of at least 2 to 1 will be maintained to ensure the Town's ability to pay short-term obligations (i.e., current asset/current liabilities greater than or equal to 2).

Issuance of Debt:

This Debt Management Policy (the "Debt Policy") of the TOWN OF FAIRFAX (the "Town") was amended by the Town Council of the Town (the "Council") on August 2, 2017. The Debt Policy may be amended by Council as it deems appropriate from time to time in the prudent management of the debt of the Town.

This Debt Policy will also apply to any debt issued by the Fairfax Financing Authority and any other public agency for which the Council acts as its legislative body.

The Debt Policy has been developed to provide guidance in the issuance and management of debt by the Town or its related entities and is intended to comply with Section 8855(i) of the California Government Code 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 Town'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 Town.

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

1. Findings

This Debt Policy shall govern all debt undertaken by the Town. The Town hereby

FINANCIAL POLICIES

recognizes that a fiscally prudent debt policy is required in order to:

- Maintain the Town's sound financial position.
- Ensure the Town has the flexibility to respond to changes in future service priorities, revenue levels, and operating expenses.
- Protect the Town's credit-worthiness.
- Ensure that all debt is structured in order to protect both current and future taxpayers, ratepayers and constituents of the Town.
- Ensure that the Town's debt is consistent with the Town'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 Town 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 Town Manager and the Finance Director 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 Town'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.

(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 Town, or to produce overall debt savings by refinancing other existing debt i.e., pension liability.

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

- When the project to be financed is necessary to provide basic services.
- When the project to be financed will provide benefit to constituents over multiple

FINANCIAL POLICIES

years.

- When total debt does not constitute an unreasonable burden to the Town 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) The Town will not use long-term debt financings for current operating expenses or routine maintenance expenses.

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

- The project to be financed has been or will be approved by the 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 Town to violate any covenants to maintain the tax-exempt status of such debt, if applicable.
- The Town estimates that sufficient income or revenues will be available to service the debt through its maturity.
- The Town determines that the issuance of the debt will comply with the applicable requirements of state and federal law.
- The Town considers the improvement/facility to be of vital, time-sensitive need of the community and there are no plausible alternative financing sources

(d) Periodic reviews of outstanding long-term debt will be undertaken to identify refunding opportunities. Refunding (e.g., refinancing) 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 be undertaken to achieve Town objectives relating to changes in covenants, call provisions, operational flexibility, tax status of the issuer, or the debt service profile.

In general, refundings which produce a net present value savings of at least three (3) percent of the refunded debt will be considered economically viable. However, the Town may determine that the non-economic benefits/objectives derived or achieved from refunding support a less than three percent net present value savings.

(ii) Long-term Debt/OPEB

(a) Other Postemployment Benefits (OPEB) provide eligible retired employees of the Town of Fairfax with retiree health care benefits. The Town will prepare bi-annual actuarial reports to determine the Town's Annual Required Contribution (ARC) toward OPEB. The Governmental Accounting Standards Board (GASB) has released GASB 75 as a required standard for determining OPEB accounting, beginning with the 2017-18

FINANCIAL POLICIES

fiscal year. Under GASB 75, an Actuarially Determined Contribution (ADC) replaces the ARC.

(b) Since 2010, the Town has met its required ARC and has, at times, prefunded OPEB accrued liabilities. It is the Town's policy to continue to pay the Actuarially Determined Contribution per GASB 75 and, based on availability of resources, consider annually pre-funding its OPEB unfunded liabilities. The Town budgets for the ADC payment in each fiscal year budget.

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

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

Short-term borrowing, includes commercial paper, and lines of credit, or other short-term loans. 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 Council determines that extraordinary circumstances exist, must not exceed seven (7) years.

(iiiiv) Financings on Behalf of Other Entities. The Town 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 Town. In such cases, the Town 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 Town 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 Town of Fairfax 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 shall be authorized by the requisite number of voters in order to pass.

FINANCIAL POLICIES

- 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 Town must comply with proposition 218 regarding rate adjustments.
- Lease-Backed Debt/Certificates of Participation (COP/Lease Revenue Bonds): Issuance of Lease-backed debt is a commonly used form of debt that allows a Town 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 Town from the general fund. Lease-Backed debt does not constitute indebtedness under the state or the Town's constitutional debt limit and does not require voter approval.
- Special Assessment/Special District Debt: The Town may 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 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 Town's credit rating, the Town will also comply with all State guidelines regarding the issuance of special district or special assessment debt, as well as any policy required to be adopted under Government Code Section 53312.7.

The Town may in exceptional circumstances make findings 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 Town 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 Town 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 in 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 should be limited to no more than 20 percent of the total debt portfolio.

The Town 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

FINANCIAL POLICIES

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 Town intends to issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the Town's capital budget and the capital improvement plan.

The Town 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 Town 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 Town 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 Town's public purposes.

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

It is a policy goal of the Town 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 Town will comply with applicable state and federal law as it pertains to the maximum term of debt and the procedures for levying and imposing any related taxes, assessments, rates and charges.

It shall be the policy goal of the Town to realize net present value savings whenever refinancing or refunding debt. In determining the appropriate level of net present value savings, the Town Council should consider any non-financial policy considerations in their decision making process.

FINANCIAL POLICIES

E. Internal Control Procedures

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

The Town 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 Town'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 Town will submit written requisitions for such proceeds. The Town will submit a requisition only after obtaining the signature of the Town Manager or the Finance Director.

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 Town 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 Town in accordance with applicable laws.

G. Credit Rating

1. The Town will seek to maintain and, if possible, improve its current bond rating(s) in order to minimize costs and preserve access to credit.
2. It is the Town's goal to maintain the highest possible credit rating, given the Town's financial position, from a major rating agency. The Town may pay the bond insurance which is considered as part of the rating, however, the rating agency does evaluate the structure of the bond to validate the bond rating. The factors that contribute to a high rating include the Town's financial management practices, low debt levels, budgetary and fiscal controls, and accountability. To support this policy, the Town will continue to maintain its position of full financial disclosure and proactive fiscal planning.

RESOLUTION 18-__

**A RESOLUTION OF THE TOWN COUNCIL OF THE TOWN OF FAIRFAX
AMENDING THE DEBT MANAGEMENT FINANCIAL POLICIES**

WHEREAS, the Town's current Debt Management Financial Policies were adopted on May 16, 2016, and amended on August 2, 2017; and

WHEREAS, the Town Council now wishes to amend its current Debt Management Financial Policies formalize its practice to fully fund the Town's annual OPEB contributions , to continue to pay the Actuarially Determined Contribution per GASB 75 and, based on availability of resources, to consider annually pre-funding its OPEB unfunded liabilities; and

WHEREAS, the amended Debt Management Financial Policies have been developed and reviewed by the Town's Finance Committee;

NOW, THEREFORE, BE IT HEREBY RESOLVED by the Town Council of the Town of Fairfax that the Debt Management Financial Policies, in the form attached hereto as Exhibit A (the "Debt Management Policies"), is hereby adopted.

The foregoing Resolution was duly passed and adopted at a regular meeting of the Town Council of the Town of Fairfax, held in said Town on the 18th day of July 2018, by the following vote, to wit:

AYES:

NOES:

ABSENT:

PETER LACQUES, Mayor

Attest: _____
Michele Gardner, Town Clerk

Exhibit A

ATTACHMENT B

FINANCIAL POLICIES

8. DEBT MANAGEMENT POLICIES

With the exception of funding for prudent cash flow needs in the form of Tax and Revenue Anticipation Notes (TRAN), a ratio of current assets to current liabilities of at least 2 to 1 will be maintained to ensure the Town's ability to pay short-term obligations (i.e., current asset/current liabilities greater than or equal to 2).

Issuance of Debt:

This Debt Management Policy (the "Debt Policy") of the TOWN OF FAIRFAX (the "Town") was amended by the Town Council of the Town (the "Council") on August 2, 2017. The Debt Policy may be amended by Council as it deems appropriate from time to time in the prudent management of the debt of the Town.

This Debt Policy will also apply to any debt issued by the Fairfax Financing Authority and any other public agency for which the Council acts as its legislative body.

The Debt Policy has been developed to provide guidance in the issuance and management of debt by the Town or its related entities and is intended to comply with Section 8855(i) of the California Government Code 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 Town'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 Town.

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

1. Findings

This Debt Policy shall govern all debt undertaken by the Town. The Town hereby

FINANCIAL POLICIES

recognizes that a fiscally prudent debt policy is required in order to:

- Maintain the Town's sound financial position.
- Ensure the Town has the flexibility to respond to changes in future service priorities, revenue levels, and operating expenses.
- Protect the Town's credit-worthiness.
- Ensure that all debt is structured in order to protect both current and future taxpayers, ratepayers and constituents of the Town.
- Ensure that the Town's debt is consistent with the Town'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 Town 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 Town Manager and the Finance Director 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 Town'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.

(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 Town, or to produce overall debt savings by refinancing other existing debt i.e., pension liability.

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

- When the project to be financed is necessary to provide basic services.
- When the project to be financed will provide benefit to constituents over multiple

FINANCIAL POLICIES

years.

- When total debt does not constitute an unreasonable burden to the Town 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) The Town will not use long-term debt financings for current operating expenses or routine maintenance expenses.

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

- The project to be financed has been or will be approved by the 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 Town to violate any covenants to maintain the tax-exempt status of such debt, if applicable.
- The Town estimates that sufficient income or revenues will be available to service the debt through its maturity.
- The Town determines that the issuance of the debt will comply with the applicable requirements of state and federal law.
- The Town considers the improvement/facility to be of vital, time-sensitive need of the community and there are no plausible alternative financing sources

(d) Periodic reviews of outstanding long-term debt will be undertaken to identify refunding opportunities. Refunding (e.g., refinancing) 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 be undertaken to achieve Town objectives relating to changes in covenants, call provisions, operational flexibility, tax status of the issuer, or the debt service profile.

In general, refundings which produce a net present value savings of at least three (3) percent of the refunded debt will be considered economically viable. However, the Town may determine that the non-economic benefits/objectives derived or achieved from refunding support a less than three percent net present value savings.

(ii) Long-term Debt/OPEB

(a) Other Postemployment Benefits (OPEB) provide eligible retired employees of the Town of Fairfax with retiree health care benefits. The Town will prepare bi-annual actuarial reports to determine the Town's Annual Required Contribution (ARC) toward OPEB. The Governmental Accounting Standards Board (GASB) has released GASB 75 as a required standard for determining OPEB accounting, beginning with the 2017-18

FINANCIAL POLICIES

fiscal year. Under GASB 75, an Actuarially Determined Contribution (ADC) replaces the ARC.

(b) Since 2010, the Town has met its required ARC and has, at times, prefunded OPEB accrued liabilities. It is the Town's policy to continue to pay the Actuarially Determined Contribution per GASB 75 and, based on availability of resources, consider annually pre-funding its OPEB unfunded liabilities. The Town budgets for the ADC payment in each fiscal year budget.

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

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

Short-term borrowing, includes commercial paper, and lines of credit, or other short-term loans. 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 Council determines that extraordinary circumstances exist, must not exceed seven (7) years.

(iii) Financings on Behalf of Other Entities. The Town 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 Town. In such cases, the Town 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 Town 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 Town of Fairfax 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 shall be authorized by the requisite number of voters in order to pass.

FINANCIAL POLICIES

- 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 Town must comply with proposition 218 regarding rate adjustments.

- Lease-Backed Debt/Certificates of Participation (COP/Lease Revenue Bonds): Issuance of Lease-backed debt is a commonly used form of debt that allows a Town 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 Town from the general fund. Lease-Backed debt does not constitute indebtedness under the state or the Town's constitutional debt limit and does not require voter approval.

- Special Assessment/Special District Debt: The Town may 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 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 Town's credit rating, the Town will also comply with all State guidelines regarding the issuance of special district or special assessment debt, as well as any policy required to be adopted under Government Code Section 53312.7.

The Town may in exceptional circumstances make findings 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 Town 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 Town 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 in 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 should be limited to no more than 20 percent of the total debt portfolio.

The Town 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

FINANCIAL POLICIES

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 Town intends to issue debt for the purposes stated in this Debt Policy and to implement policy decisions incorporated in the Town's capital budget and the capital improvement plan.

The Town 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 Town 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 Town 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 Town's public purposes.

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

It is a policy goal of the Town 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 Town will comply with applicable state and federal law as it pertains to the maximum term of debt and the procedures for levying and imposing any related taxes, assessments, rates and charges.

It shall be the policy goal of the Town to realize net present value savings whenever refinancing or refunding debt. In determining the appropriate level of net present value savings, the Town Council should consider any non-financial policy considerations in their decision making process.

FINANCIAL POLICIES

E. Internal Control Procedures

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

The Town 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 Town'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 Town will submit written requisitions for such proceeds. The Town will submit a requisition only after obtaining the signature of the Town Manager or the Finance Director.

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 Town 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 Town in accordance with applicable laws.

G. Credit Rating

1. The Town will seek to maintain and, if possible, improve its current bond rating(s) in order to minimize costs and preserve access to credit.
2. It is the Town's goal to maintain the highest possible credit rating, given the Town's financial position, from a major rating agency. The Town may pay the bond insurance which is considered as part of the rating, however, the rating agency does evaluate the structure of the bond to validate the bond rating. The factors that contribute to a high rating include the Town's financial management practices, low debt levels, budgetary and fiscal controls, and accountability. To support this policy, the Town will continue to maintain its position of full financial disclosure and proactive fiscal planning.