Debt Management Policy

1. Introduction/Purpose

The purpose of the Solano County (County) Debt Management Policy (Policy) is to ensure sound and uniform practices for issuing and managing debt. The County recognizes that it may need to enter into debt obligations to finance projects and to meet fiscal responsibilities. Accordingly, this Policy confirms the commitment of the Board of Supervisors (Board), staff, advisors and other decision makers to adhere to sound financial management practices.

The County's Comprehensive Annual Financial Report lists a number of legally separate organizations for which the Board is financially accountable. This Policy defines the actions of these component units to ensure a uniform approach to the issuance of debt.

2. Policy Objectives

The Policy objectives are as follows:

- Establish a systematic and prudent approach to debt issuance and debt management.
- Ensure access to debt capital markets and direct purchase investors (private placement providers) on the most favorable possible terms to the County through prudent and flexible policies.
- Define specific limits or acceptable ranges to general fund supported debt and pension obligation debt.

3. Scope

This Policy governs the issuance and management of all debt, leases and financing activity by County entities and component units. The debt policies and practices of the County are subject to and limited by applicable provisions of state and federal law and to prudent debt management principles.

The County uses financing techniques prescribed under existing law for projects that require financing beyond the current fiscal year. These techniques can include, but are not limited to, certificates of participation, lease-back arrangements, general obligation bonds, and revenue and assessment bonds.

4. Debt Advisory Committee

The Debt Advisory Committee (DAC) was formed by and is advisory to the County Administrator's Office (CAO). The DAC is responsible for reviewing all proposed financing and providing the CAO with a recommended course of action. The DAC may utilize the services of an independent Financial Advisor when analyzing proposed financing. The DAC consists of three members: Assistant County Administrator, Treasurer-Tax Collector-County Clerk (Treasurer), and Auditor-Controller.

5. Delegation of Authority

Government Code § 53635.7 requires that all borrowing be placed on the Board Agenda as a separate item of business. This Policy requires that the Board specifically authorize each financing proposal based on the recommendation of the CAO. Policy implementation and the day-to-day responsibility for and authority over the County's debt program will lie with the Auditor-Controller and Treasurer with participation from other departments and outside advisors and consultants as necessary.

This policy will be reviewed annually and updated as necessary. Any changes to the Policy are subject to approval by the DAC and the Board. The County recognizes that changes in the capital markets, County programs, and other unforeseen circumstances may produce situations not covered by this Policy. This may require modifications or exceptions to achieve Policy objectives. In these cases, flexibility is appropriate, provided specific authorization from the Board or the component unit's Board of Directors is obtained.

The County is committed to long-term capital and financial planning, maintaining appropriate reserve levels and employing prudent practices in governance, management and budget administration. Policies related to these topics are adopted separately, but affect this Debt Management Policy in the context of the overall long-term financial plan.

6. Standards for Debt Financing

The County will minimize its debt burden by incurring debt only in those cases where public policy, public interest and/or economic efficiency favor debt over cash financing or grant funding. In addition, the County shall use self-supporting (debt-service neutral or better) debt when possible. The County in most cases will issue debt to finance capital projects. Other possible reasons to issue debt include, but are not limited to, refinancing unfunded pension liabilities, allowing the County to cover periods of temporary cash shortfalls, refinancing bonds, and paying obligations imposed by law. Except to alleviate cash-flow timing issues within a fiscal year, the County will avoid using debt to finance reoccurring operating expenses. All debt issuances will fall within the limits permitted by the California Constitution and state law.

A. Credit Ratings

Consistent with the County's objectives, the County will work to ensure all debt issuances receive the highest credit ratings possible.

B. Debt Issuance Requirements

All debt is required to undergo a DAC review prior to receiving the recommendation of the CAO and the approval of the Board. The debt will be limited by the constraints described in section 9, "Debt Level / Affordability Targets".

C. Method of Sale

The County's goal is to protect the public's interest by obtaining the lowest possible interest cost within a framework of maintaining annual debt commitments within budgetary preferences and constraints. To obtain this goal, the County may use a competitive, negotiated, limited-competitive hybrid or private placement method of sale. The appropriate method should be determined on a case-by case basis.

Before selecting a method of sale for public offerings, the financing team shall take into consideration relevant factors that may include the current market, the issuer's characteristics, and the proposed bond structure. Market considerations will focus on the supply and demand of competing issuances. Issuer characteristic considerations will include market familiarity, credit strength, and policy goals. Bond structure considerations will include the type of debt instrument, issue size, structure, and timing.

The County prefers the use of competitive sale for public offerings. However, if the Financial Advisor believes that pre-sale marketing will enhance the County's ability to sell bonds on the most favorable terms, the financing team should evaluate the benefits and legality of a limited-competitive or negotiated sale.

Due to the limited liquidity of private placements, public offerings will typically offer a lower cost of funds. However, the County may consider a private placement for smaller issuances with shorter terms, more complex bond structures, or financings with short lead times.

D. Derivatives

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. Accordingly, derivative products should only be employed after careful evaluation of potential benefits and risks with prior DAC and Board approval.

E. Bond Counsel and Financial Advisor Requirements

Where appropriate, Bond and /or Disclosure Counsel and a Financial Advisor will be engaged.

F. Economies of Scale

The County will bundle projects into fewer transactions to achieve economies of scale associated with costs of issuance when feasible.

G. Arbitrage Regulations

Generally, tax-exempt bond issues are subject to IRS arbitrage rebate requirements. These requirements specify that any profit or arbitrage be rebated to the Federal Government. Rebate computations are typically required every five (5) years and upon final redemption or maturity of the bonds. Any excess earnings are required to be related to the Federal Government. The County may engage an outside rebate consultant to assist it in complying with these requirements.

H. Conflict of Interest

All financing team members will be required to provide full and complete disclosure, relative to agreements with other financing team members and outside parties. The extent of disclosure may vary depending on the nature of the transaction. However, in general terms, no agreements will be permitted which could compromise the firm's ability to provide independent advice that is solely in the County's interests (to the extent the firm's role involves a duty to do so) or which could reasonably be perceived as a conflict of interest. The County acknowledges that the underwriter or the purchaser of the debt has a conflict of interest with the County. The County and the underwriters will act in their own self-interest and are not subject to pressure of duress from the other party.

I. Purpose of Debt

There are two basic types of debt new money financings and refunding financings.

i. New Money Financings

The County may issue long-term debt in order to generate funding for capital projects. Short-term debt may be issued to generate funding for cash flow needs.

ii. Refunding Financings

Refunding bonds are issued to retire all or a portion of an outstanding bond issue or other debt. Such bonds can be used to achieve present value savings on debt service, to modify interest rate risk, or to restructure the payment schedule, type of debt instrument used, or covenants of existing debt. The County must analyze each refunding bond on a present value basis to evaluate the economic effects. Policies on the administration of refunding bonds are detailed in Section 6.L. "Refunding Bonds".

J. Types of Debt / Terms of Debt – New Money

There are a variety of debt structures the County may consider to meet its funding needs.
Short term debt includes tax and revenue anticipation notes (TRANs), commercial paper, grant anticipation notes, bond anticipation notes and lines of credit. Long term debt structures include, but are not limited to, general obligation (GO) bonds, special assessment district bonds, lease revenue bonds, certificates of participation, enterprise revenue bonds, sales tax revenue bonds, asset securitizations and pension obligation bonds (POBs).

The County may also participate in conduit financing, in which the Board may approve the issuance of bonds for the purposes of commercial, industrial, or residential property development. This type of financing does not create a financial obligation of the County.

K. Debt Terms – New Money

Term and Structure: Long-term debt financing of capital projects will be for a period not to exceed 120% of the expected average useful life of the assets being financed, and in no event should exceed thirty (30) years. Debt Service will be structured to be level over the length of the bonds except in those instances where it is economically advantageous to the County or meets other County objectives to structure debt service differently. Short term debt and structure will be determined on a case-by-case basis and will be consistent with appropriate legal and tax requirements.

Coupon Premiums and Discounts: Coupon Premiums and Discounts shall be determined on a case-by-case basis as recommended by the Financial Advisor.

Call Provisions: Debt will be structured with the shortest possible Optional Call consistent with optimal pricing and County objectives.

Debt Service Reserve Fund: For long term debt and where appropriate for short-term debt, the County will evaluate the use of a Debt Service Reserve Fund based on the prevailing standards in the municipal bond market, expected ratings on the debt, and other factors to achieve optimal pricing. Alternately, a Surety Bond may be evaluated and used if found to be economically advantageous.

Capitalized Interest: All interest due from the date of debt issuance may be rolled into principal until substantial completion of the project being funded unless another asset pledge or other sources of funds are available.

Variable Rate Debt: To maintain a predictable debt service burden, the County will give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is floating or variable rate debt. It may be appropriate to issue short-term or long-term variable rate debt to diversify the County's debt portfolio, reduce interest costs, in the relative short term, provide interim funding for capital projects or improve the match of assets to liabilities.

Budgetary safeguards should be in place before incurring variable rate debt, and such debt should never amount to more than 20% of all outstanding debt. Before incurring variable rate debt, careful consideration should be given to current market conditions and trends, including the costs and availability of Liquidity Facilities. The County's cost for administering variable rate debt should be considered when comparing fixed and variable rate debt.

Credit Enhancement: The County will consider the use of credit enhancements on a case-by-case basis, evaluating the economic benefit versus the cost for each case. Examples of credit enhancement include, but are not limited to, bond insurance, direct-pay letters of credit, stand-by letters of credit and other credit enhancements and should be used only when they clearly demonstrate a net present value savings to the County.

Senior/Subordinate: Senior and Subordinate debt will be utilized in a manner that will minimize the costs of financing or maximize debt capacity.

L. Refunding Bonds (Debt Refinancing)

The County is responsible for acting upon refunding opportunities that offer significant savings over the maintenance of existing debt.

Periodically, the County will analyze and evaluate debt repayment opportunities based on current market conditions. Additionally, the County may request or receive analysis of an opportunity to refund existing debt from a Financial Advisor or other municipal financial market participant. The County will consider such opportunities and evaluate the economic benefit they may present.

i. Debt Service Savings

The County has established a minimum present value cash flow savings threshold goal .of three (3) percent of the refunded bond principal amount. A refinance may also be considered if other compelling reasons exist as described below.

The present value savings will be net of all costs of the refinancing, will consider the difference in interest earnings of the debt service reserve funds of the refunded and refunding bonds, and may include any cash associated with the refunded bonds held by the Trustee. The decision to take the savings on an upfront or deferred basis must be approved by the Board after recommendation by the DAC and the CAO.

ii. Guiding Principles

In evaluating refunding opportunities and applying the above referenced guidelines, the DAC and staff shall, when appropriate, also consider the following:

Adjustments to the savings threshold for Advance Refundings, may be justified based on the length of time before the call of the bonds to be refunded. The longer the escrow, the higher the savings threshold should be. Conversely, shorter escrows may justify a lower savings threshold.
The County should consider a forward refunding to preserve the ability to advance refund the bonds at a future date for Advance Refundings with very short escrows.

Adjustments to savings thresholds for both Advance Refundings and Current Refundings, may be justified based on:

- The length of time from the call to maturity. The longer the time to maturity, the higher the savings threshold should be. Conversely, a shorter time to maturity may justify a lower savings threshold.
- Interest rates at the time of the refunding relative to historical markets. In low interest rate markets a lower threshold may be justified while a higher threshold would be justified in high interest rate markets.
- The coupon structure and/or callability of the refunding bonds may also justify adjustments to the savings threshold. Non-callable refunding bonds, for example, might justify a higher threshold.

iii. Restructuring

The County will refund debt when it is in its best interest to do so. Refundings will generally include restructuring to meet unanticipated revenue expectations, terminate Swaps, achieve cost savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants.

iv. Term of Refunding Issues

The County will generally refund bonds within the term of the originally issued debt. However, the County may consider maturity extension to achieve a desired outcome, provided that such extension is legally permissible. The County may also consider shortening the term of the originally issued debt to realize greater interest savings.

v. Escrow Structuring

The County shall, where practical, utilize the least costly securities available in structuring refunding escrows. The County will examine the viability of an economic versus legal Defeasance on a net present value basis. A certificate from a third party agent, who is not a broker-dealer, is required. Said certificate must state that the securities were procured through an arm's length, competitive bid process (in the case of open market securities); that such securities were more cost effective than State and Local Government Obligations; and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an Underwriter, Agent or Financial Advisor sell escrow securities to the County from its own account.

vi. Arbitrage

The County shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refundings. Any resulting positive arbitrage will be rebated according to Federal guidelines.

7. Debt Level / Affordability Targets

The County shall establish an affordable level of debt in order to preserve credit quality and ensure financial stability. As such, aggregate General Fund lease debt service should fall within a range of four to six percent (4%-6%) of General Fund Expenditures. The County shall maintain a debt affordability model with ratios recalculated at the time of a new debt issue. The DAC and the Board will be notified if any new issuance would cause the ratio to exceed the threshold. Both DAC and Board approval would be required before the County is allowed to exceed the ratio threshold.

A component unit may be allowed to exceed the above target ratio if the unit generates user fees through a business-type activity. The component unit must, however, repay the debt with money generated by user fees or other dedicated revenue sources.

The above target ratio does not include POB debt service or the County’s pension and retiree health care unfunded actuarial accrued liabilities (UAAL), which itself is a form of “debt” owed to retirement plan members. POB’s are used to refund the County's UAAL at a lower cost to achieve cost savings and shall be issued only after careful consideration by the DAC and Board of potential benefits and risks.

Considerations shall include:

- the spread between the expected borrowing rate and the assumed rate of return on retirement plan assets
- investment risk associated with the investment of POB proceeds
- issuing a sufficient amount of POB's to generate market interest; and
- the County's overall pension burden, including both POB debt and UAAL. The County has established that the debt service for POBs should not exceed 5%-7% of total County expenditures, without consideration of UAAL. To the extent that rating agency or other metrics are available, the County's pension burden shall be compared to that of other comparable agencies.

8. Annual Reporting / Continuing Disclosure / Internal Control Procedures

The County will prepare an annual debt obligation report (the "Report") for distribution to the DAC, CAO, Board, and general public. The Report will include:

- the total County debt as of June 30 of that year
- each debt obligation's interest rate, term, and annual payment
- any refinancing that occurred that year

All existing County debt should be compliant with Continuing Disclosure Certificate requirements. All future debt issues should also be compliant.

Each responsible County department, agency, district or authority issuing or managing debt will:

- observe all applicable state and federal regulations and laws regarding disclosure
- file all annual reports and material specified event notices with the appropriate agencies in a timely manner
- file a specified event notice pursuant to Rule 15c2-12 under the Securities Exchange Act of 1934

The County will conduct "due diligence" meetings with all relevant County staff prior to the issuance of new bonds and notes. A Preliminary Official Statement will be released to the market only after the completion of the "due diligence" meetings.

The County shall be vigilant in using debt proceeds in accordance with the debts stated purposes at the time such debt was incurred.

In furtherance of the policy:

i The County shall only use proceeds of debt for the purposes approved by the Board of Supervisors.
ii Written requisitions identifying the amount and purpose of a proposed draw of bond or other debt proceeds shall be signed by the County Administrator or designee and submitted to the appropriate County officials or trustee, as applicable.

9. New Financing Methods and Techniques

Changing federal regulations and the shifting concerns of rating agencies mean that Counties operate in a dynamic financial environment. This Policy is not intended to hinder the County's use of any new financing techniques that may arise.

Proposals for financing methods not included in this Policy should be addressed to the DAC. If the DAC approves of such financing methods, the DAC should recommend their use to the CAO. This Policy should then be amended to reflect any new financing techniques recommended by the DAC and approved by the Board.

10. Conclusion

This Policy is intended to guide and regulate the County's issuance of debt. The County is aware, however, that the financial environment may change and that this Policy may therefore require a review or update. Should circumstances dictate this Policy should be modified to remain relevant in the current financial environment.