Government Finance Officers Association

Debt Policies

Part 5

Topics

- Conditions for debt issuance
- Financial limitations
- Debt issuance process
- Debt management process

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Conditions for Debt Issuance

Acceptable Conditions for Debt

- There are favorable market conditions
  - There are good interest rates
  - The construction market is soft
- Bond ratings are investment grade
  - Project supports an investment grade rating
- Distributes costs and benefits appropriately
  - Intergenerational equity concerns
  - Public vs. individual benefits
- Project has a certain minimum useful life

Example Policies for Conditions

- The assets funded by debt issuance shall have a life expectancy that is equal to or greater than the final maturity of the bonds issued.
- Bond refunding will be considered if the present value savings is X percent or greater.
  - The smaller the bond issue the greater the % of savings needs to be
  - Volatile markets can change the amount of the savings very quickly

Restrictions on Debt Issuance

- Using debt to fund operations
  - Multi-year debt will not be used to pay for ongoing expenditures.
- Length of issuance
  - Final maturity will not be longer than the useful life of the asset (s)
- Size of issuance
  - Maximums or minimums
- Prohibit certain types of debt
  - Derivatives are a common example

Financial Limitations

Common Indicators

- Measure impact of debt on budget
  - ☐ Debt service as a % of expenditures
    - Total debt service payments per year shall be no greater than X% of operating costs for the fund.
- Measure community's ability to support debt
  - ☐ Debt per capita
  - ☐ Debt divided by assessed value or full cash value
  - ☐ Also consider these measures from overlapping perspective

S&P's Analytical Characterizations

Debt Service as a Percentage of Expenditures	
Low	Below 8%
Moderate	8% - 15%
Elevated	15 – 20%
High	Above 25%

S&P's Analytical Characterizations

S&P's Analytical Characterizations of Debt Levels (Overlapping)			
Debt Compared to Population		**Debt Compared to Market Value**	
Very Low	Below $1,000	Low	Below 3%
Low	$1,000 - $2,000	Moderate	3% - 6%
Moderate	$2,000 - $5,000	Moderately High	6% - 10%
High	Above $5,000	High	Above 10%

Setting Limits

- Use rating agency guidelines plus a review of comparable communities to establish a baseline
- Use professional judgment to the select limits that made sense in this context and that will prove valuable to elected officials.

Sedgwick County's Approach

- *The County will not engage in debt financing unless the proposed obligation, when combined with all existing debts, will result in debt ratios throughout the life of the proposed obligation that are less than <u>at least three</u> of the following benchmarks:*
  - ☐ *Per capita direct debt will not exceed $500*
  - ☐ *Per capita direct, overlapping and underlying debt will not exceed $3,000*
  - ☐ *Direct debt as a percentage of estimated full market value will not exceed 1.5%*
  - ☐ *Direct, overlapping and underlying debt as a percentage of estimated full market value will not exceed 6.0%*
  - ☐ *Annual debt service will not exceed 20% of budgeted expenditures*

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Debt Issuance Process

Key Policies

- Approval of Issuance
  - Who can authorize debt and under what conditions?
- Determining the Method of Sale
  - State preference for competitive sales
  - Describe conditions for negotiated sales
    - A refinancing is dependent on market/interest rate timing.
    - The debt is unique and requires particular skills from the underwriter(s) involved.
    - There is a compressed time line due to extenuating circumstances and a competitive process cannot be accomplished.
- Selection and Use of Professional Service Providers
  - Describe selection process
  - Evaluation procedures

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Debt Management Process

Key Policies

- Investment of bond proceeds
  - Arbitrage limits is the most important consideration
  - Policy should require that steps be taken to minimize arbitrage liability
- Compliance practices
  - Policy for a system of arbitrage monitoring and filing
  - Comply with bond covenants and ordinances
  - Post issuance compliance has become more rigorous and it is best to have a specific policy

Take-Aways

- Debt policies can help give decision-makers confidence in using debt as a financing tool
- Preconditions for issuance demonstrate how debt can be used responsibly
- Financial limitations on debt define what is affordable
- Debt issuance and management policies show how the actual use of debt will be accomplished responsibly