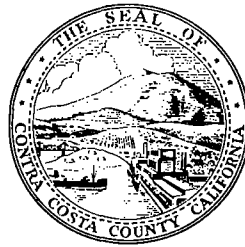


TO: BOARD OF SUPERVISORS

FROM: FINANCE COMMITTEE
Mary N. Piepho, Chair
John Gioia

DATE: December 19, 2006

SUBJECT: **County Debt Management Policy**



**Contra
Costa
County**

SD.y

SPECIFIC REQUEST(S) OR RECOMMENDATION(S) & BACKGROUND AND JUSTIFICATION

RECOMMENDATION:

CONSIDER accepting report from the Finance Committee on the need for a formal County Debt Management Policy and adopting Resolution 2006/773 to enact such a policy.

FISCAL IMPACT:

No specific fiscal impact.

BACKGROUND:

On December 7, 2006 the Finance Committee reviewed and discussed a report regarding establishing a County Debt Management Policy. The Committee directed staff to report to the full Board on December 19, 2006 the recommendation to adopt the attached County Debt Management Policy (Resolution 2006/773).

During the 2006 calendar year, the Board of Supervisors worked exceptionally hard to address the County's financial issues. The Board of Supervisors set very ambitious and necessary goals for lowering cost growth, balancing the budget, and increasing reserves. These solutions were aimed at addressing both short and long term needs and improving the County's future ability to maintain public services. There are four major financial areas the County Administrator's office identified which would benefit from formal policies, three of which have been established:

- Budget Policy (established November 2006)
- General Fund Reserve policy (established December 2005)
- Facilities Maintenance (included in Budget Policy)
- Debt Policy (no formal policy)

CONTINUED ON ATTACHMENT: _____ YES

SIGNATURE: _____

Handwritten signature of Lisa Driscoll.

☒ RECOMMENDATION OF COUNTY ADMINISTRATOR
APPROVE _____ OTHER _____

☒ RECOMMENDATION OF BOARD COMMITTEE

SIGNATURE(S): _____

ACTION OF BOARD ON 12/19/06

APPROVED AS RECOMMENDED

☒ OTHER _____

VOTE OF SUPERVISORS

☒ VACANT SEAT: DISTRICT III
UNANIMOUS (ABSENT ☒)
AYES: _____ NOES: _____
ABSENT: _____ ABSTAIN: _____

Contact: Lisa Driscoll 335-1023

Cc: Steve Ybarra, Auditor Controller
County Budget Cabinet (via CAO)

I HEREBY CERTIFY THAT THIS IS A TRUE AND CORRECT COPY OF AN ACTION TAKEN AND ENTERED ON MINUTES OF THE BOARD OF SUPERVISORS ON THE DATE SHOWN.

ATTESTED

12/19/06

JOHN CULLEN, CLERK OF THE BOARD OF SUPERVISORS

BY: , DEPUTY

The California Debt and Investment Advisory Commission (CDIAC) provides information, education and technical assistance on public debt, investments, and economic development financing tools to local public agencies and other public finance professionals. In March 2006, CDIAC updated its 'Debt Issuance Primer'. This Primer, sample financial policies from other public agencies, the Government Finance Officers Association's article on 'Best Practices in Public Financing', and the County's financial advisor were resources deployed in the development of this report and its recommendation regarding establishment of a formal debt policy to complete the County's key policy initiatives.

Debt Affordability Standards and Debt Policies

Generally, debt is a method of spreading out the cost of a capital improvement or public program over time and should not be considered an additional source of revenue¹. Because there are restrictions on local agency revenue sources, the County needs a way to gauge the effect of ongoing debt service on its budgets and fiscal priorities over time.

Debt affordability standards will help the County to evaluate when, why, and how much debt should be issued. These standards should include target ratios for debt. These ratios can be based on assessed valuation of property, revenues, population, system users, or other factors relevant to specific types of issues. The ratios may be varied depending on factors such as volatility of revenue streams, concentration of tax or revenue base, overall community policies, and preferences regarding debt and the overall need for capital investment.

In addition to debt affordability standards, the County should consider adopting a formal debt policy.

A debt policy:

- Establishes parameters for issuing and managing debt
- Provides guidance to decision makers so as not to exceed the debt affordability standards
- Directs staff on objectives to be achieved both pre- and post-issuance
- Promotes objectivity in decision-making and limits the role of political influence
- Facilitates the process by considering and making important policy decisions in advance of an actual financing

Debt policies can be helpful in maintaining and improving the County's general credit rating and worthiness, as explicitly recognized by Standard and Poor's in its new Financial Management Assessment service. The elements of a debt policy will vary for a county versus a city or a state, and should reflect the scope of activities the issuer is likely to undertake in the debt financing arena. In addition, it is important that the debt policy reflect community standards and attitudes about debt. Debt policies should address such issues as:

- The types of debt that will be issued
- Structural features with respect to the debt
- Method(s) of sale of debt (i.e. circumstances under which negotiated or competitive sales will be used)
- Refundings/Refinancing
- Selection of consultants
- Disclosure practices
- Arbitrage rebate and continuing disclosure compliance
- Investment of bond proceeds

Strategic planning for debt issuance, in light of the County's capital outlay program, also should be addressed with a view to giving the County the ability to access the market when it expects to need funds while avoiding an unnecessarily high number of issuances in a short period of time.

Planning should take advantage of opportunities to pool financing, where appropriate, to save on costs of issuance as well as building in flexibility in scheduling to avoid being forced to issue in a high interest rate environment.

¹ In some cases (as with general obligation bonds or land-secured financings), the statutes permitting the issuance of debt also permit the levying of taxes or assessments to pay debt service.

Contra Costa County, California Debt Management Policy

County Administration
651 Pine Street, 10th Floor
Martinez, California 94553
925-335-1023
FAX 925-646-1353
ldris@cao.cccounty.us

Resolution No. 2006/773

**DEBT MANAGEMENT POLICY
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Contra Costa County, California

Debt Management Policy

I. PURPOSE: The County recognizes the foundation of any well-managed debt program is a comprehensive debt policy. A debt policy sets forth the parameters for issuing debt and managing outstanding debt and provides guidance to decision makers regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, method of sale that may be used and structural features that may be incorporated. The debt policy should recognize a binding commitment to full and timely repayment of all debt as an intrinsic requirement for entry into the capital markets. Adherence to a debt policy helps to ensure that a government maintains a sound debt position and that credit quality is protected. Advantages of a debt policy are as follows:

- enhances the quality of decisions by imposing order and discipline, and promoting consistency and continuity in decision making,
- provides rationality in the decision-making process,
- identifies objectives for staff to implement,
- demonstrates a commitment to long-term financial planning objectives, and
- is regarded positively by the rating agencies in reviewing credit quality.

The scope of this initial policy (the "Debt Policy") is intended to include only General Fund financings (i.e. County Tax and Revenue Anticipation Notes, Certificates of Participation, and General Obligation bonds), with Redevelopment debt and Assessment District debt incorporated into future updates of the Debt Policy.

II. DEBT AFFORDABILITY ADVISORY COMMITTEE

A. Purpose. By adoption of this Debt Policy, the Debt Affordability Advisory Committee is established. Its purpose is to annually review and evaluate existing and proposed new County debt and other findings and/or issues the committee considers appropriate.

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 County Administrator defining debt capacity of the County. This review will be an important element of the budget process and will include recommendations made by the committee regarding how much new debt can be authorized by the County without overburdening itself with debt service payments.

B. Members. The committee shall be composed of the Auditor-Controller, Treasurer-Tax Collector, Director/Community Development Department, and Senior Deputy County Administrator/Finance Manager.

C. Debt Affordability Measures. The committee shall examine specific statistical measures to determine debt capacity and relative debt position and compare these ratios to other counties, rating agency standards and Contra Costa County's historical ratios to determine debt affordability. From Moody's Investors Service, the committee will evaluate the County against the following three debt ratios from the most recent available national medians for counties in the "Aa" rating tier contained in Moody's "Municipal Financial Ratio Analysis – U.S. Counties (Population > 1 million)" and for the County's cohort group in Moody's "California County Medians":

1. Direct net debt as a percentage of Assessed Valuation;
2. Overall net debt as a percentage of Assessed Valuation; and
3. Assessed Valuation per-capita.

From Standard and Poor's, the committee will evaluate the County against the following three debt ratios from the most recent available national medians for counties in the "AA" rating tier :

1. Percentage of total fund equity;
2. Percentage of unreserved fund equity; and
3. Direct debt per-capita.

III. COMPREHENSIVE CAPITAL PLANNING

A. Planning. The County Administrator's Office shall prepare a multi-year capital program for consideration and adoption by the Board of Supervisors as part of the County's budget process. Annually, the capital budget shall identify revenue sources and expenditures for the coming current year and the next succeeding three fiscal years. The plan shall be updated annually.

B. Funding of the Capital Improvement Program. Whenever possible, the County will first attempt to fund capital projects with grants or state/federal funding, as part of its broader capital improvement plan. When such funds are insufficient, the County will use dedicated revenues to fund projects. If these are not available, the County will use excess surplus from the reserve and debt financing, general revenues. The County shall be guided by three principles in selecting a funding source for capital improvements: equity, effectiveness and efficiency.

1. Equity: Whenever appropriate, the beneficiaries of a project or service will pay for it. For example, if a project is a general function of government that benefits the entire community, such as an Office of Emergency Services, the

project will be paid for with general purpose revenues or financed with debt. If, however, the project benefits specific users, such as a building permit facility, the revenues will be derived through user fees or charges, and assessments.

2. Effectiveness: In selecting a source or sources for financing projects, the County will select one or more that effectively funds the total cost of the project. For example, funding a capital project, or the debt service on a project, with a user fee that does not provide sufficient funds to pay for the project is not an effective means of funding the project.

3. Efficiency: If grants or current revenues are not available to fund a project, the County will generally select a financing technique that provides for the lowest total cost consistent with acceptable risk factors and principals of equity and effectiveness. These methods currently consist of County issued debt, special funding programs funded by state or federal agencies, or special pool financing. Examples include funding pools like the Association of Bay Area Governments Participation Certificates.

C. Maintenance, Replacement and Renewal/FLIP. The County intends to set aside sufficient current revenues to finance ongoing maintenance needs and to provide periodic replacement and renewal consistent with its philosophy of keeping its capital facilities and infrastructure systems in good repair and to maximize a capital asset's useful life.

D. Debt Authorization. No County debt issued for the purpose of funding capital projects may be authorized by the Board of Supervisors unless an appropriation has been included in the capital budget (Some forms of debt such as Private Activity Bonds for housing, Mello-Roos for infrastructure, and redevelopment bonds for infrastructure/facilities may not be appropriate for inclusion in the County capital improvement program. These forms of debt are currently covered under separate policy).

IV. PLANNING AND STRUCTURE OF COUNTY INDEBTEDNESS

A. Overview. The County shall plan long- and short-term debt issuance to finance its capital program based on its cash flow needs, sources of revenue, capital construction periods, available financing instruments and market conditions. The Senior Deputy County Administrator/Finance Manager shall oversee and coordinate the timing, issuance process and marketing of the County's borrowing and capital funding activities required in support of the capital improvement plan. The County shall finance its capital needs on a regular basis dictated by its capital spending pattern. Over the long-term this policy should result in a consistently low average interest rate. When market conditions in any one year result in higher than average interest rates, the County shall seek refinancing opportunities in subsequent years to bring such interest rates closer to the average. The Debt

Affordability Advisory Committee shall use the Government Financial Officers Association checklist set forth in the Appendix hereto in planning and structuring any debt issuances.

B. Financing Team. The County employs outside financial specialists to assist it in developing a debt issuance strategy, preparing bond documents and marketing bonds to investors. The key team members in the County's financing transactions include its financial advisor and outside bond and disclosure counsel, the underwriter and County representatives (the County Auditor-Controller, Treasurer-Tax Collector, and the Senior Deputy County Administrator/Finance Manager, among others). Other outside firms, such as those providing paying agent/registrar, trustee, credit enhancement, verification, escrow, auditing, or printing services, are retained as required. The financing team shall meet at least semi-annually to review the overall financing strategy of the County and make recommendations to the County Administrator.

C. Term of Debt Repayment. Borrowings by the County shall mature over a term that does not exceed the economic life of the improvements that they finance and usually no longer than 20 years, unless special structuring elements require a specific maximum term to maturity, as is the case with pension obligation bonds. The County shall finance improvements with a probable useful life less than five years using pay-go funding for such needs. Bonds sold for the purchase of equipment with a probable useful life exceeding five years are repaid over a term that does not exceed such useful life.

D. Legal Borrowing Limitations/Bonds and other indebtedness. California Government Code Section 29909 limits General Obligation Bond indebtedness to five percent of the total assessed valuation of all taxable real and personal property within the County, excluding Public Financing Authority lease revenue bonds, Public Facility Corporation certificates of participation, Private Activity Bond, Mello-Roos special tax, and Assessment District Debt for which no legal limitations are currently in effect.

E. Debt Features.

1. Original issue discount or premium. The County's bonds may be sold at a discount or premium, in order to achieve effective marketing, achieve interest cost savings or meet other financing objectives. The maximum permitted discount is stated in the Notice of Sale accompanying the County's preliminary official statement on the Bond Purchase Agreement, as applicable.

2. Debt service structure/Level Debt Service. The County shall primarily finance its long-lived municipal improvements over a 20-year term or less, on a level debt service basis. This policy minimizes long-run impact on a funding department's budget. The County will seek to continue this practice, unless

general fund revenues are projected to be insufficient to provide adequately for this debt service structure.

3. Call provisions. The County shall seek to minimize the protection from optional redemption given to bondholders, consistent with its desire to obtain the lowest possible interest rates on its bonds. The County's tax-exempt bonds are generally subject to optional redemption. The County seeks early calls at low or no premiums because such features will allow it to refinance debt more easily for debt service savings when interest rates drop. The County and its financial advisor shall evaluate optional redemption provisions for each issue to assure that the County does not pay unacceptably higher interest rates to obtain such advantageous calls. The County shall not sell derivative call options.

4. Interest rates. The County shall first consider the use of fixed-rate debt to finance its capital needs, except for short-term needs (such as short-lived assets) that will be repaid or refinanced in the near term; and may consider variable rate debt under favorable conditions.

F. Other Obligations Classified as Debt/Other Post Employment Benefits (OPEB)/Vested Vacation Benefits. OPEBs and vacation benefits are earned by County employees based on time in service. The County records these vacation benefits as earned in accordance with generally accepted accounting principles as established by the Governmental Accounting Board (GASB). The liability for the benefit is recorded on the Fund level financial statements. The expense is recorded during the conversion to the Government Wide financial statements in accordance with GASB standards. For Enterprise funds the expense and liability are accrued in the respective funds. In this initial policy, the amount of OPEB and vacation benefits will not be in measures used to evaluate the County's debt affordability. However, the County's net OPEB obligation, if any, will be posted to the County's balance sheet beginning FY 2007/08, at which point such an obligation may be viewed as debt by the rating agencies.

V. METHOD OF SALE. The County will select a method of sale that is the most appropriate in light of financial, market, transaction-specific and County-related conditions, and explain the rationale for its decision.

A. Competitive Sales. Debt obligations are generally issued through a competitive sale. The County and its financial advisor will set the terms of the sale to encourage as many bidders as possible. By maximizing bidding, the County seeks to obtain the lowest possible interest rates on its bonds. Some of the conditions that generally favor a competitive sale include:

1. the market is familiar with the County;
2. the County is a stable and regular borrower in the public market;

3. there is an active secondary market with a broad investor base for the County's bonds;
4. the issue has a non-enhanced credit rating of A or above or can obtain credit enhancement prior to the competitive sale;
5. the debt structure is backed by the County's full faith and credit or a strong, known or historically performing revenue stream;
6. the issue is neither too large to be easily absorbed by the market nor too small to attract investors without a concerted sale effort;
7. the issue does not include complex or innovative features or require explanation as to the bonds' security;
8. the issue can be sold and closed on a schedule that does not need to be accelerated or shortened for market or policy reasons; and
9. interest rates are stable, market demand is strong, and the market is able to absorb a reasonable amount of buying or selling at reasonable price changes.

B. Negotiated Sales. When certain conditions favorable for a competitive sale do not exist and when a negotiated sale will provide significant benefits to the County that would not be achieved through a competitive sale, the County may elect to sell its debt obligations through a private placement or negotiated sale, upon approval by the County Board of Supervisors. Such determination shall be made on an issue-by-issue basis, for a series of issues, or for part or all of a specific financing program. The following practices are recommended to be observed in the event of a negotiated sale:

1. ensure fairness by using a competitive underwriter selection process through a request for proposals where multiple proposals are considered;
2. remain actively involved in each step of the negotiation and sale processes to uphold the public trust;
3. ensure that either an employee of the County, or an outside professional other than the issue underwriter, who is familiar with and abreast of the condition of the municipal market, is available to assist in structuring the issue, pricing, and monitoring sales activities;
4. require that the financial advisor used for a particular bond issue not act as underwriter of the same bond issue;
5. require that financial professionals disclose the name or names of any person or firm, including attorneys, lobbyists and public relations professionals compensated in connection with a specific bond issue;
6. request all financial professionals submitting joint proposals or intending to enter into joint accounts or any fee-splitting arrangements in connection with a bond issue to fully disclose to the County any plan or arrangements to share tasks, responsibilities and fees earned, and disclose the financial professionals with whom the sharing is proposed, the method used to calculate the fees to be earned, and any changes thereto; and

7. review the "Agreement among Underwriters" and insure that it is filed with the County and that it governs all transactions during the underwriting period.

VI. REFINANCING OF OUTSTANDING DEBT. The County may undertake refinancings of outstanding debt under the following circumstances:

A. Debt Service Savings. The County may refinance outstanding long-term debt when such refinancing allows the County to realize significant debt service savings (2% minimum by maturity on its own and a minimum 4% savings overall on its own or if combined with more than one refinancing) 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.

B. 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.

VII. CREDIT RATINGS

A. Rating Agency Relationships. The Senior Deputy County Administrator/Finance Manager is responsible for maintaining relationships with the rating agencies that assign ratings to the County's various debt obligations. This effort includes providing periodic updates on the County's general financial condition along with coordinating meetings and presentations in conjunction with a new debt issuance.

B. Quality of Ratings. The County shall request ratings prior to the sale of securities from each of two major rating agencies for municipal bond public issues. Currently these agencies are Moody's Investors Service and Standard & Poor's Corporation. The County shall provide a written and/or oral presentation to the rating agencies to help each credit analyst make an informed evaluation. The County shall make every reasonable effort to maintain its Aa implied general obligation bond credit ratings.

VIII. MANAGEMENT PRACTICES. The County has instituted sound management practices and will continue to follow practices that will reflect positively on it in the rating process. Among these are the County development of and adherence to long-term financial and capital improvement plans, management of expense

growth in line with revenues and maintenance of an adequate level of operating reserves.

A. Formal Fiscal Policies. The County shall continue to establish, refine, and follow formal fiscal policies such as: Investment Policy, General Fund Reserve Policy, Budget Policy, and this Debt Management Policy.

B. Rebate Reporting and Covenant Compliance The Senior Deputy County Administrator/Finance Manager is responsible for maintaining a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code and/or contracting for such service. This effort includes tracking investment earnings on debt proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the County's outstanding debt issues. Additionally, general financial reporting and certification requirements embodied in bond covenants are monitored to ensure that all covenants are complied with.

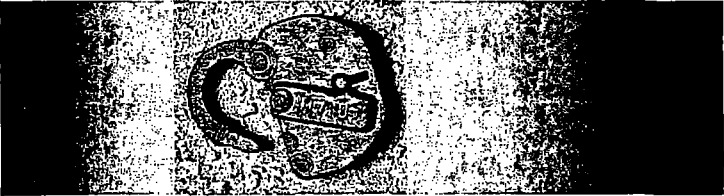
C. Reporting Practices. The County will comply with the standards of the Government Finance Officers Association for financial reporting and budget presentation and the disclosure requirements of the Securities and Exchange Commission.

APPENDIX

GOVERNMENT FINANCE OFFICERS ASSOCIATION

Checklist of Debt Policy Considerations

1. How long is the capital planning period?
2. Have all non-debt sources of funds been considered?
3. How are borrowing plans reviewed internally?
4. What level of debt is manageable in order to maintain or improve the government's credit quality?
5. How much "pay-as-you-go" financing should be included in the capital plan?
6. How much short-term borrowing will be undertaken, including both operating and capital borrowings?
7. How much debt will be issued in the form of variable-rate securities?
8. How does the redemption schedule for each proposed issue affect the overall debt service requirements of the government?
9. What types of affordability guidelines will be established to help monitor and preserve credit quality?
10. What provisions have been made to periodically review the capital plan and borrowing practices?
11. What is the overlapping debt burden on the taxpayer?
12. How will the formal debt policies be integrated into the capital planning and funding process?



Debt Management Policy

December 19, 2006

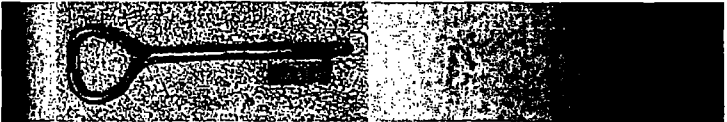
S&P's Financial Management Assessment

- Revenue & Expenditure Assumptions • Standard
- Budget Amendments & Updates • Strong
- Long-term Financial Planning • Strong
- Long-term Management Policies • Strong
- Debt Management Policies • Standard
- Reserve & Liquidity Policies • Strong



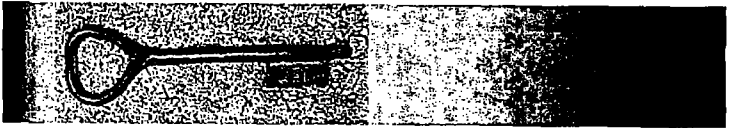
A Debt Policy

- Establishes parameters for issuing & managing debt
- Provides guidance – when, why & how much debt to issue
- Directs pre- and post-issuance objectives
- Promotes objectivity in decision-making
- Facilitates the process by establishing policy decisions in advance of financing



Scope of this Policy

- Intended to include only General Fund financing (i.e. County Tax and Revenue Anticipation Notes, Certificates of Participation, and General Obligation bonds
- Redevelopment debt and Assessment District debt will be incorporated into future updates of this debt policy



Purpose

Ad debt policy guides:

- Timing for issuing and managing debt
- Purpose for which debt may be issued
- Types of permissible debt
- Method of sale
- Structural features



Debt Affordability Advisory

- Establishes Committee to annually review and evaluate existing and proposed new County debt
- Annually examines specific statistical measures to determine debt capacity and relative debt position



Comprehensive Capital Planning

- Multi-year capital program (considered as part of budget)
- Directs funding (equity, effectiveness, efficiency)
- FLIP (Facilities Life-Cycle Investment Prg)
- Debt authorization (appropriation)



Planning & Structure of Indebtedness

- Plan long- and short-term debt to finance capital program based on cash flow needs, sources of revenue, construction periods, available financing instruments and market conditions
- Financing Team
- Term of Debt Repayment (20 years)
- Legal Borrowing Limitations
- Debt Features (issue, structure/level debt service, call provisions, fixed interest rates)
- Other Obligations (OPEB, vacation benefits)

Method of Sale

- Seek most appropriate method, includes
 - Competitive Sales – policy includes some of the conditions which favor this type of sale
 - Negotiated Sales (private placement or negotiated sale) – determination shall be made on an issue-by-issue basis following the practices recommended in the policy for a negotiated sale

Refinancing Outstanding Debt

- Debt service savings (2% minimum by maturity on its own or 4% combined, minimize lengthening of term, no increase to debt service
- Defeasance (refinancing – advance funding) – allowable when the public policy benefits outweigh the costs

Credit Ratings

- Rating Agency relationships
- Quality of ratings

Management Practices

- Formal fiscal policies
- Rebate reporting & covenant compliance
- Reporting practices

Request Adoption of Debt Management Policy

