
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Numbers: 330 and 331

Debt Policy

OVERVIEW

A draft City Debt Policy was presented to the Budget and Finance Committee for consideration on July 25, 2007. The IBA provided comments on the initial draft Debt Policy in Report #07-70. In response to those comments and comments received from the Committee, the Debt Management Director and CFO presented a revised draft Debt Policy to the Budget and Finance Committee on September 26, 2007.

The City has never had a formal, written Debt Policy that comprehensively addresses procedures and goals for the use of debt to finance City needs.

In Report #07-92, the IBA provided additional comments and recommendations related to the revised draft Debt Policy. In unanimously voting to forward the Debt Policy to the City Council, the Budget and Finance Committee requested that several changes or additions be made to the draft Debt Policy in accordance with IBA recommendations and their discussion. This report reviews the further amended Debt Policy and comments on changes requested by the Committee.

FISCAL/POLICY DISCUSSION

Although a few of the requested supporting policies have yet to be developed for inclusion into the larger Debt Policy, the Debt Management Department has begun to incorporate all of the changes requested by the Budget and Finance Committee on

September 26, 2007. The IBA has listed each of the Committee requests below and commented on the status of its incorporation into the draft Debt Policy:

- 1) The Redevelopment Agency and Housing Authority should develop their own debt policies to be incorporated into the Appendix section of the City's Debt Policy.

Comment: The Mayor's Report to the City Council #07-172 specifies "a policy for the Redevelopment Agency debt issuances will also be developed and brought forward at a future date for consideration by the Committee and the Redevelopment Agency by Agency staff." The IBA recommends that staff be directed to note that a redevelopment debt policy is currently being developed for review by the City Council and inclusion into the Appendix section of the City's Debt Policy. This notation should be placed in the Redevelopment Agency Debt Obligations section on pages 8 and 9. Understanding that a redevelopment debt policy will take some time to develop, we would recommend that the City Council request that a policy be provided to them for consideration and inclusion into the new Debt Policy before the end of FY 08.

The Housing Authority has maintained a policy for their Multifamily Mortgage Revenue Bond Program since 1989. This policy is now referenced on page 10 of the Debt Policy and included as Appendix C. As this policy has been in effect for some time, the IBA would recommend that it be reviewed and updated, if necessary, before the end of FY 08.

- 2) The Debt Policy should be amended to indicate that it would be annually reviewed by the Mayor's staff with any needed changes recommended to the Budget and Finance Committee.

Comment: This change is consistent with the GFOA Elected Official's Guide on Debt Issuance, which recommends that all state and local governments adopt comprehensive written debt management policies and that these policies be reviewed at least annually, and revised as necessary. In the last paragraph on page 2, the Debt Policy provides that "After the initial adoption, an annual review of the Debt Policy will be performed and any changes to the Debt Policy will be brought forward for City Council consideration and approval." The IBA would suggest that an annual report to the City Council, or the Budget and Finance Committee, would be an excellent opportunity to discuss the policy as it relates to financial market developments and/or the City's anticipated financing calendar for the coming year.

- 3) Operations and maintenance costs for capital improvement projects should be discussed before a financing is proposed. A budget recommendation to cover the anticipated O&M costs should be made before bonds are authorized for a capital improvement project.

Comment: The Budget and Finance Committee and the CFO agreed that operations and maintenance costs must be considered and planned for before work begins to issue debt for a capital improvement project. In the first paragraph under section 1.1 (A.) on page 3, the Debt Policy provides that “In accordance with the CIP Prioritization Policy, future operations and maintenance costs associated with capital improvement projects will be developed and identified prior to submission of the project for approval.” The IBA notes that the CIP Prioritization Policy has yet to be presented and discussed at the Budget and Finance Committee or the City Council. We would recommend that the City Council request that the CIP Prioritization Policy be discussed and approved for inclusion into the new Debt Policy before the end of FY 08.

- 4) The Debt Management Department should develop a policy for the utilization of variable rate debt and derivative options.

Comment: Sections 5.4 and 5.5 of the draft Debt Policy contemplate the utilization of variable rate debt and/or derivative options. A Variable Rate Debt and Derivative Options Policy has yet to be developed. The Debt Management Department is planning to provide a workshop for the City Council in January 2008 on this topic in order to solicit City Council feedback to best develop the requested policy.

The IBA supports the plan for a workshop. In IBA Report #07-92, we suggested that the City Council learn more about the benefits and considerations associated with variable rate debt or derivative options before they are asked to approve such a debt structure. The IBA recommends that sections 5.4 and 5.5 of the draft Debt Policy note that a Variable Rate Debt and Derivative Options Policy will be developed for City Council approval and inclusion into the Appendix section of the Debt Policy, utilizing feedback from a planned workshop. We would further recommend that the City Council request that this policy be presented for adoption and inclusion into the new Debt Policy before the end of FY 08.

- 5) Recommend repealing Council Policy 800-03, Public Infrastructure Financing Assessment Districts and Community Facilities, understanding that a replacement policy was being developed for inclusion into the new Debt Policy.

Comment: The Debt Management Department is bringing the new Special District Formation and Financing Policy forward as a companion (item #331) to the Debt Policy (item #330). The new policy has been amended to strengthen the credit quality of land-backed debt issued by the City, reduce maximum tax and assessment rates for property owners within a special district and provide for more flexibility in the utilization of bond funds. These changes are described in detail within the Mayor's Report to the City Council #07-171.

The IBA supports the recommended changes because they strengthen credit quality and better protect bondholders and special district residents; however, it should be noted that these advantages result in a financing tool that may be a little less advantageous to developers that the City may wish to support. As the policy changes were only briefly discussed at the Budget and Finance Committee, the IBA recommends that the City Council ask staff any questions that they may have before adopting the new policy for inclusion into the Appendix section of the Debt Policy.

- 6) Councilmember Frye asked if the CFO could list City financial obligations that were not covered by the Debt Policy. The IBA was asked to comment on this. Councilmember Frye again requested that the City Attorney provide legal analysis as to why only some debt is included as such in the City's Debt Policy.

Comment: In the third paragraph on page 1, the Debt Policy lists those financial obligations not covered by the Policy. This same paragraph has been further amended to reference where these outstanding long-term liabilities are listed in the City's annual financial statements. While these liabilities could be listed in the Appendix section of the Policy, the IBA believes that up-front disclosure on page 1 of the Overview, with specific references to the City's annual financial statements, reasonably addresses Councilmember Frye's suggestion.

On October 30, 2007, Chief Deputy City Attorney Mark Blake issued a memorandum to Councilmember Frye in response to her request (see Attachment 1). Citing a published GFOA recommended practice on debt management policy, Mr. Blake comments that the GFOA's recommended practice "does not necessarily define the term debt." He further suggests that the City could use those affordability metrics described in sections 4.1 through 4.3 of the Policy to annually analyze the all-in debt burdens placed on its citizens. The IBA has previously commented on debt affordability measures in reports #07-70 and #07-92. If these metrics are to be annually calculated, we recommend that they only be utilized

internally so as not to confuse rating agencies or potential investors who do not expect pension or OPEB liabilities to be included in commonly evaluated debt affordability metrics.

CONCLUSION

“A debt management policy improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates a commitment to long-term financial planning, including a multi-year capital plan. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner.” – GFOA

The IBA has reviewed the amended Debt Policy to ensure that recommendations from the Budget and Finance Committee have been incorporated. We have recommended within this report that supporting policies be either reviewed (Multifamily Mortgage Revenue Bond Program) or developed (Redevelopment Agency Debt Policy, CIP Prioritization Policy, and a Variable Rate Debt and Derivative Options Policy) for City Council adoption and incorporation into the new Debt Policy by the end of this

fiscal year. The IBA has also recommended adoption of the new Special District Formation and Financing Policy and suggested that the City Council ask any questions they may have before adopting the new policy, as substantive changes have been made to the pre-existing policy being replaced.

The IBA commends the Mayor for bringing forward a comprehensive Debt Policy for City Council consideration. The City Council may also wish to reference IBA reports #07-70 and #07-92 on this subject. Provided that the requested supporting policies referenced above will be incorporated in FY 08, the IBA recommends that the City Council adopt the proposed City Debt Policy.

“Issuing debt commits a government’s revenues several years into the future, and may limit the government’s flexibility to respond to changing service priorities, revenue inflows, or cost structure. Adherence to a debt policy helps ensure that debt is issued and managed prudently in order to maintain a sound fiscal position and protect credit quality.” – GFOA

[SIGNED]

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Attachment