

City of McPherson Debt Policy

For Long-Term Obligation Financing Statement

A Strategy for the Acquisition or Replacement of City Assets

PURPOSE

The Debt Policy for Long-Term Obligation Financing Statement sets forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that (1) the City obtain financing only when necessary, (2) the process for identifying the timing and amount of long-term obligation financing or other financing be as efficient as possible and (3) the most favorable interest rate and other related costs be obtained.

Long-term financing, to include general obligation bonds, special assessment bonds, revenue bonds, KDHE revolving loans, temporary notes, lease/purchase agreements, and other City obligations permitted to be issued or incurred under Kansas law, should be used to purchase capital assets that cannot be acquired from either current revenues or fund balances needed to fund infrastructure improvements and additions. The useful life of the asset or project should exceed the payout schedule of any long-term financing the City assumes.

To enhance creditworthiness and prudent financial management, the City is committed to systematic capital planning, intergovernmental cooperation and coordination, and long-term financial planning. Among other things, evidence of this commitment to capital planning will be demonstrated through adoption and periodic adjustment of the City's Comprehensive Plan and the adoption of an annual Capital Improvement Plan (CIP).

Notwithstanding anything to the contrary herein, this Policy shall be interpreted as a guideline to assist and guide the governing body in the exercise of its discretion and shall not be interpreted as an enforceable limit on such discretion.

RESPONSIBILITY FOR POLICY

The primary responsibility for developing long-term financing recommendations rests with the Commissioner of Finance and Revenue for the City of McPherson. In developing such recommendations, the Commissioner of Finance and Revenue shall be assisted by the City Administrator and the City Treasurer/Finance Director, the three of whom shall comprise the Long-Term Finance Management Committee. The responsibilities of this Committee shall be to:

- Meet as necessary to consider the need for long-term financing and assess progress on the current Capital Improvement Program and any other program/improvement deemed necessary by the City Commission;
- Meet at least semi-annually to test adherence to this policy statement and to review applicable long-term financing ratios serving as benchmarks;
- Review changes in federal and state legislation that affect the City's ability to issue long-term financing and report such findings to the City Commission as appropriate;
- Review annually for the City's compliance with the provisions of ordinances authorizing issuance of general obligation bonds of the City;
- Review semi-annually the opportunities for refinancing current long-term obligations; and,
- Review annually the services provided by the City's financial advisor, bond trustees, bond counsel, paying agents and other long-term financing service providers.

Prior to meeting, the City Treasurer/Finance Director shall prepare a written report on the financial status of the City's current Capital Improvement Program. The report shall be based in part on information collected from department heads for the City and shall include a projection of near term financing needs compared to available resources, an analysis of the impact of contemplated financings on the property tax rate and user charges, and a final financing recommendation.

In developing financing recommendations, the Long-Term Finance Management Committee shall consider:

- The time proceeds of obligations are expected to remain on hand and their related carrying costs;
- The options for interim financing including short term and inter-fund borrowing, taking into consideration federal and state reimbursements;
- The effect of proposed actions on the tax rate and user charges;
- Trends in bond markets;
- Trends in interest rates; and,
- Other factors as deemed appropriate.

USE OF LONG-TERM OBLIGATION FINANCING

Absent extraordinary circumstances, long-term financing should not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The City should use long-term financing only for one-time capital improvement projects and unusual equipment purchases included under the following circumstances:

- When the project is included in the City's five-year capital improvement program and is in conformance with the City's general plan;
- When the project is not included in the City's five-year capital improvement program, but it is an emerging need whose timing was not anticipated in the five-year capital improvement program, or it is a project mandated immediately by state or federal requirements, or it is a project for which grant money has been offered and the matching funds are not readily available from other sources;
- When the project is the result of growth-related activities within the community that require unanticipated and unplanned infrastructure or capital improvements by the City;
- When the project's useful life, or the projected service life of the equipment, will be equal to or exceed the term of the financing; or
- When there are designated revenues sufficient to service a long-term financing, whether from project revenues, other specified and reserved resources, or infrastructure cost sharing revenues.

The following criteria should be used to evaluate pay-as-you-go versus long-term financing in funding capital improvements:

Factors which favor pay-as-you-go long-term financing include circumstances where:

- Current revenues and fund balances are available;
- A phasing-in of projects is feasible;
- Additional long-term financing levels would adversely affect the City's credit rating; or,
- Market conditions are unstable or suggest difficulties in marketing a long-term financing issue.

Factors which favor long-term financing include circumstances where:

- Revenues available for long-term debt issues are considered sufficient and reliable so that long-term financing can be marketed with an appropriate credit rating, which can be maintained;
- Market conditions present favorable interest rates;
- A project is mandated by state or federal government and current revenues or fund balances are insufficient to pay project costs;
- A project is immediately required to meet or relieve capacity needs; or
- The life of the project or asset financed is five years or longer.

STRUCTURE AND TERM OF LONG-TERM OBLIGATION FINANCING DEBT

General

City long-term financing will be structured to achieve the lowest possible net interest cost to the City given market conditions, the urgency of the capital project, and the nature and type of any security provided. Moreover, to the extent possible, the City will design the repayment of its overall long-term debt issues so as to rapidly recapture its credit capacity for future use. As a benchmark, the City shall strive to repay at least 20% of the principal amount of its general obligation bonds, excluding special assessment bonds, within five years and at least 40% within ten years.

General Obligation Bonds

The City should use an objective analytical approach to determine whether it can afford to assume new general obligation bonds beyond what it retires each year (*see Assumption of Additional Long-Term Financing below*). Generally, this process will include a comparison of City Commission approved benchmarks relative to key demographic data of the City.

These benchmarks should include, at a minimum, ratios reflecting long-term debt per capita, long-term debt as a percent of taxable value, long-term debt service payments as a percent of current revenues and current expenditures, and the level of overlapping net long-term debt of all local taxing jurisdictions. This process should also examine the direct costs and quantifiable benefits of any proposed expenditures.

The decision on whether or not to assume new general obligation bonds should, in part, be based on (a) costs and benefits, (b) the current conditions of the municipal bond market, and (c) the City's ability to assume new general obligation bonds as determined by the aforementioned benchmarks.

NOTE: *The provisions of this section also apply to the issuance of any private activity bonds.*

Revenue Bonds

For the City to issue new revenue bonds, projected annual revenues as defined by the ordinance authorizing such issuance, should be a minimum of 125% of the issue's average annual revenue bond service. If necessary, annual adjustments to the City's rate structures will be considered in order to maintain 125% coverage factor.

Special Assessment Bonds

The City should maintain a watchful attitude over the issuance of special assessment bonds for benefit district improvements. While the City's share of any benefit district project may fluctuate, under Kansas law, the City should not pay more than 95% of any proposed costs related to a benefit district. Further, it

will be the responsibility of the Long-Term Finance Management Committee to analyze each special assessment bond issue for indications that future property taxes will equal or exceed the annual principal and interest payments on the annual amortization of such bonds. A report on the findings of the Long-Term Finance Management Committee will be submitted to the City Commission prior to approval of any special assessment bond issue.

Assumption of Additional Long-Term Financing

Generally, the City should not assume more tax-supported general obligation bond debt (excluding special assessment bonds) than it retires each year without conducting an objective analysis as to the community's ability to assume and support additional general obligation bond service payments.

Whenever appropriate, self-supporting revenue bonds shall be issued before general obligation bonds.

Asset Life

The City should consider long-term financing for the acquisition, replacement, or expansion of physical assets (including land) only if a capital project has a useful life longer than the term of the bond issue supporting it. Long-term financing should be used only to finance capital projects and equipment, except in case of unforeseen emergencies. Long-term financing should not be issued for periods exceeding the useful life or average useful lives of the project or projects to be financed.

Long-Term Obligation Guarantees With Other Intergovernmental Agencies

The City may consider, on a case-by-case basis, the use of its long-term debt capacity for legally allowable capital projects by public development authorities or other special purpose units of government. The City's guarantee of long-term debt service coverage should be made only (1) after the prior commitment of the full assets and resources of the development authority to long-term debt coverage or a satisfactory rationale for failing to commit the full resources; (2) if project revenues, or development authority revenues pledged to long-term debt service, are at least equal to long-term debt service; (3) if long-term debt service reserves are provided by the development authority's own resources and are equal to at least six months long-term debt service or such reserve as required by the Bond documents; and, (4) if all other viable means financing have been examined.

Length of Long-Term Obligations

City long-term financing should be amortized for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users.

The City usually issues bonds with an average life of 15 years or less for general obligation bonds and 20 years or less for revenue bonds and special assessment bonds. (However, there may be special circumstances when the cost of a project necessitates a bond life greater than 15 years.) When feasible, the structure of general obligation bonds will reduce principal at a faster rate than amortization of revenue bonds or special assessment bonds. Generally, there should be no "balloon" bond repayment schedules, which consist of low annual payments and one large payment of the balance due at the end of the term. There should always be at least interest paid in the first fiscal year after a bond sale and principal starting no later than the second fiscal year after the bond issue.

Call Provisions

Call provisions for bond issues should be made as short as possible consistent with the lowest interest cost to the City. All bonds should be callable only at par.

Long-Term Obligation Structuring

At a minimum, the City should seek to amortize general obligation bonds with level principal and interest costs-over the life of the issue. Pushing higher costs to future years in order to reduce short-term budget liabilities should be considered only when natural disasters or extraordinary or unanticipated external factors make the short-term cost of general obligation bonds prohibitive.

Variable Rate Long-Term Obligations

The City may choose to issue bonds that pay a rate of interest that varies according to pre-determined formula or results from a periodic remarketing of the securities, consistent with state law and covenants of preexisting bonds, and depending on market conditions.

LONG-TERM OBLIGATION ADMINISTRATION AND FINANCING

Financing Proposals

Any capital financing proposal of a City division or agency involving the pledge or other extension of the City's credit through sale of bonds, execution of loans or leases, or otherwise involving directly or indirectly the lending or pledging of the City's credit, should be referred to the Long-Term Finance Management Committee for review before such pledge is considered by the City Commission.

Bond Fund

All payment of general obligation bonds and special assessment bonds shall be from the City's Bond & Interest Fund. The fund balance in the Bond & Interest Fund should be maintained at a level equal to or greater than the total principal and interest payable from that Fund for the upcoming semi-annual debt service payment but in no event less than the amount required under the Bond documents.

Bond Counsel

The City will utilize external bond counsel for all long-term debt issues, excluding some lease transactions as recommended by the Long-Term Finance Committee. All long-term debt issued by the City will include a written opinion by Bond Counsel affirming that the City is authorized to issue the long-term financing, stating that the City has met all Federal and State constitutional and statutory requirements necessary for issuance, and determining a long-term financing federal income tax status and such other factors as deemed necessary or prudent.

Financial Advisor

The City should utilize an external financial advisor, to be selected for a term of up to three years, through a competitive process administered by the City's Long-Term Finance Management Committee. The utilization of the financial advisor for certain long-term debt issuance will be at the discretion of the governing body and after recommendation of the Long-Term Finance Management Committee on a case-by-case basis. For each City bond sale the financial advisor will provide the City with information on pricing and underwriting fees for comparable sales by other issuers. Upon expiration of a three-year contract, the City has the option, after a request-for-proposal process, of extending or signing a new contract with the existing Financial Advisor for another three-year period(s).

Temporary Notes

Use of short-term borrowing, such as temporary notes, will generally be undertaken only if the transaction costs plus interest on a long-term financing are less than the cost of internal financing, or available cash or reserves are insufficient to meet project needs or current obligations.

Credit Enhancements

Credit enhancement (letters of credit, bond insurance, etc.) may be used if the costs of such enhancements will reduce the net service payments on the bonds.

Lease/Purchase Agreements

The use of lease/purchase agreements in the acquisition of vehicles, equipment and other capital assets shall be considered carefully relative to any other financing option or a "pay-as-you-go" basis. Although lifetime cost of a lease may be higher than other financing options or if the asset were purchased outright, this will not preclude lease/purchase agreements from being considered by the City as a funding option for certain capital projects.

Competitive Sale of Long-Term Obligations

The City, as a matter of policy, should seek to issue its general or revenue bond obligations in a competitive sale unless it is determined that such a sale method will not produce the best results for the City. In such instances where the City, through a competitive bidding for its bonds, deems the bids received as unsatisfactory or does not receive bids, it may, at the election of the City Commission, enter into negotiation for sale of the bonds.

REFUNDING OF LONG-TERM OBLIGATIONS

Periodic reviews by the Long-Term Finance Management Committee of all outstanding long-term debt will be undertaken to determine refunding opportunities. Refunding will be considered (within federal tax law constraints) if and when there is a net economic benefit of the refunding or the refunding is essential in order to modernize covenants essential to operations and management.

City staff and the financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding long-term debt. As a general rule, the present value savings of a particular refunding should exceed 3% of the refunded maturities.

Refunding issues that produce a net present value savings of less than 3% percent should be considered on a case-by-case basis. Refunding issues with negative savings should not be considered unless there is a compelling public policy objective.

In no case shall the term of special assessment bonds be extended beyond the original bond life.

CONDUIT FINANCINGS

The City may sponsor conduit financings in the form of Industrial Revenue Bonds for those activities (i.e., economic development, housing, health facilities, etc.) that have a general public purpose and are consistent with the City's overall service and policy objectives as determined by the City Commission.

All conduit financings must insulate the City completely from any credit risk or exposure.
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ARBITRAGE LIABILITY MANAGEMENT

It is the City's policy to minimize the cost of arbitrage rebate and yield restriction while complying with the law.

General

The City will not issue debt obligations except for identifiable projects with very good prospects of timely initiation in order to reduce the exposure of arbitrage issues arising. Temporary notes and subsequent general obligation bonds will be issued timely as project contracts are awarded so that debt financing will be spent for the appropriate purposes in a timely manner.

Responsibility

Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, the advice of Bond Counsel and other qualified experts should be sought whenever questions about arbitrage rebate regulations arise.

CREDIT RATINGS

Rating Agency Relationships

The Long-Term Finance Management Committee shall be responsible for maintaining relationships with the rating agencies that currently assign ratings to the City's various long-term debt. This effort shall include providing periodic updates on the City's general financial condition along with coordinating meetings and presentations in conjunction with a new long-term debt issuance.

Use of Rating Agencies

The Long-Term Finance Management Committee shall be responsible for recommending whether or not a rating should be requested on a particular financing and which of the major rating agencies should be asked to provide such a rating.

Minimum Long-Term Rating Requirements

Currently, the City's minimum rating requirement for its direct, long-term debt obligations is a rating of "A" or higher. If a given long-term financing cannot meet this requirement based on its underlying credit strength, then credit enhancement may be sought to ensure that a minimum rating of "AA" is achieved. If credit enhancement is unavailable or is determined to be uneconomical, then the obligations may be issued without a rating.

Rating Agency Presentations

Appropriate disclosure of operations and open lines of communication should be maintained with rating agencies used by the City. The Long-Term Finance Management Committee, with assistance of the City's Financial Advisor, shall prepare the necessary materials and presentation to the rating agencies.

Financial Disclosure

The City is committed to appropriate financial disclosure, and to cooperating fully with rating agencies, institutional and individual investors, City departments and agencies, other levels of government, and the general public to share clear, comprehensible, and accurate financial information. The City is committed to meeting secondary disclosure requirements on a timely and comprehensive basis.

Pursuant to K.S.A. 75-1120a, the City follows a modified cash basis of accounting designed to show compliance with the cash basis laws of the State of Kansas for all Official statements accompanying long-term debt issues, Annual Report, and continuous disclosure statements. The Long-Term Finance Management Committee shall be responsible for ongoing disclosure to established national information repositories and for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies.

TERMINOLOGY

Arbitrage. Arbitrage refers to the rebate amount due to the Internal Revenue Service where funds received from the issuance of tax-exempt debt have been invested and excess interest earnings have occurred.

General Obligation Bonds. Bonds backed by the full faith and credit of the City. The taxing power may be an unlimited ad valorem tax or a limited tax, usually on real estate and personal property. A special tax rate levied for the Bond & Interest Fund annually to pay for general obligation long-term debt service. Because it is secured by an unlimited tax levy, this structure has strong marketability and lower interest costs.

Municipal Leases Agreements. The City enters into a lease agreement with another party (typically a third-party vendor) to lease an asset over a defined period of time at a prearranged annual payment. Lease payments are made primarily from general fund revenues. The governing body has to appropriate annual payments unless it chooses not to appropriate under the Kansas cash basis law. For the security of the leaseholders, a reserve fund can be established and held by a trustee until the leases are paid.

Revenue Bonds. Bonds secured by revenues generated by the facility from dedicated user fees. Planning for such issues generally are more complex because future costs and revenues directly affect each other. Credit enhancements (e.g., insurance or letter of credit) may be needed because of the limited source of long-term debt service payments that may be available in outlying years.

Special Assessment Bonds. Bonds issued to develop facilities and basic infrastructure for the benefit of properties within the assessment district. Assessments are levied on properties benefited by the project. The issuer's recourse for nonpayment is foreclosure and the remaining long-term debt becomes the City's direct obligation.

Temporary Notes. Notes are issued to provide temporary financing, to be repaid by long-term financing. This type of bridge financing has a maximum maturity of four years under Kansas law.

Adopted – July 2009