City Council Memorandum

To: **Mayor Fasbender & City Councilmembers**
From: **Chris Eitemiller, Finance Manager and Ashley Bertrand, Senior Accountant**
Date: **June 5, 2023**
Item: **Amend City Debt Policy**

Council Action Requested:
The Council is requested to authorize the Finance Department to amend the City's Debt Policy.

Background Information:
The City's debt policy was last updated in 2005. This policy has since served as the basis for how the City of Hastings issues and manages debt.

The Government Finance Officers Association (GFOA) recommends all local governments adopt a comprehensive written debt management policy. Recommendations from their "Best Practice – Debt Management Policy" were integrated into this policy. City Finance requests this policy, as updated, be approved to comply with GFOA Best Practices.

This policy is consistent with City practices at the time of its adoption. This policy will be reviewed from time to time to ensure it remains consistent with the City's financial objectives. It can be amended in the future by the City Council.

Financial Impact:
N/A

Advisory Commission Discussion:
N/A

Council Committee Discussion:
N/A

Attachments:
City of Hastings Debt Policy

City of Hastings Debt Policy

Scope:
This policy is applicable to all debt issuances for the City of Hastings.

Purpose:
The City of Hastings chooses, by policy, to establish parameters and guidelines for the planning and implementation of its debt management program.

- The City recognizes a long-term commitment to full and timely repayment of all debt as an intrinsic requirement for entry into the capital markets.
- It is intended this policy include the following functions:
  - To facilitate the debt issuance process by making important decisions ahead of time.
  - To promote objectivity in decision making and limit the role of political influence.
- It is intended this policy will be consistent with Minnesota Statutes. In case of a discrepancy, Minnesota Statutes shall have precedence over this policy.
- The Government Finance Officers Association (GFOA) recommends all local governments adopt a comprehensive written debt management policy. Recommendations from their "Best Practice – Debt Management Policy" were integrated into this policy.
- This policy is consistent with City practices at the time of its adoption. This policy will be reviewed from time to time to ensure it remains consistent with the City's financial objectives. It can be amended in the future by the City Council.

Legal Debt Limits:
Minnesota Statutes, Section 475, prescribe the statutory debt limit that outstanding principal of debt cannot exceed 3% of estimated market value. This limitation applies only to debt that is wholly tax supported. The type of debt included is either general obligation (G.O.) debt of any size bond issue or lease revenue bond issues that are over $1,000,000 at the time of issuance. However, there are also several other types of debt that do not count against the limit. G.O. Tax Increment, G.O. Abatement, G.O. Special Assessment, G.O. Utility Revenue, and most Economic Development Authority (EDA)-issued debt are considered to have a separate revenue source other than just taxes and so are excluded from the legal debt limit calculation. EDA public project revenue bonds or lease revenue bonds with financing lease agreement with a city or county over $1,000,000 do count against the statutory debt limit.

Local ordinance does not limit the City's ability to issue debt.

Policy Debt Limits:
Uses of Debt: Debt will be used only for capital improvement projects and capital costs. The City will not utilize debt for cash borrowing, even though this is allowed by state statues.

Capital Improvement Plan & Financial Planning: The City's CIP shall contain debt assumptions which match this policy and requires a commitment to long-range financial planning which looks at multiple years of capital and debt needs.

Allowable Types of Debt:

Special Assessment Bonds: The City shall consider issuing Special Assessment Improvement Bonds (General Obligation Improvement Bonds) to finance its annual Street Reconstruction Improvement Projects as included in its Street Reconstruction CIP.

Revenue Bonds: Adequate financing feasibility studies should be performed for each revenue issue. The City should consider issuing Revenue Bonds when the pledged revenue source is appropriate, reliable, and sufficient to make the annual debt service payments throughout the life of the bonds.

Tax Increment Bonds: The City shall use Tax Increment Bonds only when the development merits special consideration and/or when there is an established tax increment financing (TIF) revenue stream to support it and other City redevelopment efforts.

General Obligation Ad Valorem Debt: The City will attempt to use special assessment, revenue, or other self-supporting debt when possible instead of general obligation ad valorem debt.

Equipment Certificates: Minnesota Statutes allow cities to issue debt, known as Equipment Certificates or capital notes, to finance the purchase of certain capital equipment.

- The City's long-term financial plan has a goal of paying for the purchase and/or replacement of its capital assets with cash reserves and/or annual operating budget appropriations.
- The City recognizes that financing the replacement of capital assets with Equipment Certificates results in higher costs and additional property tax levies.
- Explicit consideration shall be given to the magnitude of capital needs and the mix of debt and cash reserves needed to support the capital program.
- The City shall consider issuing Equipment Certificates when it is in the best interest of the City give the status of cash reserves, levy limits imposed by the State, and/or budget appropriations.

Lease Purchase Debt: The City will consider this option when the cost of the lease purchase is lower than other options or if deemed appropriate due to time constraints or other conditions.

Interfund Loans: The City shall use interfund loans for short-term cashflow needs when in the best interest of the City, consistent with the City's other financial plans, and when repayment is reasonably assured.

Other Types: Minnesota Statutes authorize other types of debt. The City may consider them if deemed appropriate due to the specific circumstances involved.

Financial Limits:

- The City Council, City Administrator and Finance Manager shall consider and have confidence that debt service payments will be met without jeopardizing the City's ability to accommodate unexpected changes in its financial position. The City's CIP may need to be adjusted to reflect the financial constraints imposed by these considerations and this Debt Management Policy.
- Direct debt is the amount of general obligation principal or lease obligations supported by taxes which are outstanding for the City only. Indirect debt is the amount of the City's share of debt of other taxing jurisdictions. Direct debt as a percentage of the City's estimated market value shall not exceed 5%.
- Total annual property tax levy for debt service to support general obligation bonds debt service should not exceed 20% of the overall annual property tax levy.

Conduit Debt:

The City will review requests for issuance of conduit debt on a case by case basis.

- The City Council will determine if the request will provide a general benefit to City residents and taxpayers.
- The City will consider requests for conduit financing which will not impair the City's credit rating.
- All costs related to conduit financing will be borne by the applicants.
- The City may ask for a fee upfront not to exceed 1% of the par amount of the issuance.
- The City shall require any conduit issuers to perform arbitrage calculations at least every five years and send a copy of the calculations to the City in case of an IRS inquiry regarding the tax-exempt status of the conduit debt.

Use of Variable Rate Debt & Derivatives:

The City will not use variable rate debt or derivative-based debt.

Debt Structuring Practices:

Term: State law limits general obligation debt to 30 years in most circumstances. The City shall not exceed 25 years in term of debt.

Term for Equipment Certificates: The city has a goal of paying for all capital equipment with a useful life of five years or less from cash reserves or annual operating budgets. State law does allow cities to issue debt (known as equipment certificates or capital notes) with a term of ten years or the useful life of the equipment if is at least 10 years. The city would prefer, within the bounds of the levy limits, to fund capital equipment on a pay-as-you-go basis. Capital equipment with a useful life greater than five years may be financed with debt, but the bond term should not exceed ten years.

- The City's collective debt shall amortize at 50% of its principal within 10 years.
- The City shall usually issue debt with level principal and interest payments.
- The City shall have a call date (pre-payment date) of no longer than 10 years on longer-term debt and 6 to 8 years on shorter term debt.

Credit Enhancement: Credit enhancements are mechanisms which guarantee principal and interest payments. They include bond insurance and a line or letter of credit. A credit enhancement, while costly, will usually bring a lower interest rate on debt and a higher rating from the rating agencies, thus lowering overall costs.

- During debt issuance planning, the Financial Advisor will advise the City whether or not a credit enhancement is cost effective under the circumstances and what type of credit enhancement, if any, should be purchased.
- In a negotiated sale, bids may be taken during the period prior to the pricing of the sale.
- In a competitive sale, bond insurance may be provided by the purchaser if the issue qualifies for bond insurance.
- The City will consider credit enhancement when cost-effective and appropriate.

Debt Issuance Practices:

Rating Agencies: The City shall utilize one of the major international rating agencies for rating its debt issuances.

- The City seeks to maintain, and if possible, improve its bond rating so its borrowing costs are minimized and its access to credit is preserved and/or enhanced.
- The City will follow a policy of full disclosure in its relations with rating agencies. Evidence of good management and full disclosure are as follows:
    - Preparation of annual financial reports in accordance with generally accepted accounting principles (GAAP).
    - Receipt of the GFOA's Certificate of Achievement for Excellence in Financial Reporting.
- The Finance Manager is responsible for maintaining communications with the rating agency.
    - The rating agency will be informed of significant developments that could affect the City's credit rating.
    - Financial information such as the City's annual financial reports and annual budgets will be made available to rating agencies on a routine, periodic basis or as needed and/or requested.

Method of Sale: The City will select a method of sale that is the most appropriate in light of financial, market, transaction-specific and issuer-related conditions.

- Competitive Bid: The City shall encourage the use of competitive sales for all issues. The terms of the sale will be set to encourage as many bidders as possible. By maximizing bidding, the City seeks to obtain the lowest possible interest rates on its bonds. Competitive sales will be used unless circumstances dictate otherwise, such as when the debt is so specialized in its nature that it will not attract sufficient bids or in other situations where the method of sale will not result in the best outcome for the City.
- Negotiated Sale - A securities sale through an exclusive arrangement between the issuer and an underwriter or underwriting syndicate. At the end of successful negotiations, the issue is awarded to the underwriters.
- Private placement sales may be used. If private placement to banks are utilized, the City will voluntarily report terms and financial conditions associated with the debt on EMMA and other appropriate websites for bondholders, rating agency, and public disclosure.

Refunding:

- The City may undertake refunding debt for a number of reasons, including to achieve savings on debt service costs and to restructure outstanding debt, or to change burdensome bond covenants.
- Prior to beginning a refunding bond issue, the City will review an estimate of the savings achievable from the refunding. The City may also review a pro forma schedule estimating the savings, assuming that the refunding is done at various points in the future.
- Current refunding bonds shall be utilized when present value savings of 3% of refunded principal is achieved or in concert with other bond issues to save costs of issuance.
- Advance refunding bonds shall not be utilized unless present value savings 4% to 5% of refunded principal is achieved and unless the call date is within 4 years. The state law minimum is 3% of refunded principal. Bonds shall not be advance refunded if there is a reasonable chance that revenues will be sufficient to pre-pay the debt at the call date.
- Special assessment or revenue debt will not be considered for specific outstanding bond issues, if the Finance Manager determines that pledged special assessments and/or other revenues will be collected soon enough and are sufficient enough to pay off the callable portion of the debt outstanding at that call date.

Professional Services:

- Bond Counsel: The City will retain an independent Bond Counsel for debt issues. Debt issued by the City will include a written opinion by Bond Counsel affirming that the City is authorized to issue the debt, stating that the City has met all state statutory requirements necessary for issuance, and determining the debt's federal income tax status.
- Financial Advisor: The City will seek the advice of an independent Financial Advisor when necessary. The Financial Advisor will advise on the structuring of obligations to be issued, inform the City of various options, advise the City as to how choices will impact the marketability of City obligations and will provide other services as defined by contract approved by the City Council.
- Costs incurred by the City, such as Bond Counsel and Financial Advisor fees, printing, underwriters' discount, and project design and construction costs, will be charged to the bond issue to the extent allowable by law.

Debt Management Practices

Investment of Bond Proceeds:

- The City shall invest bond proceeds in a manner consistent with its Investment Policy.
- Care will be exercised in an attempt to match investment maturities with expected cash disbursements.
- Bond proceeds will not be commingled with operating funds to facilitate arbitrage compliance.

Disclosure: The City shall comply with Securities and Exchange Commission (SEC) Rule 15c2-12 rule on primary and continuing disclosure. The Finance Manager is responsible for ensuring that these requirements are met. The City has contracted with its Financial Advisor to perform the services necessary to comply, such as providing annual financial information and notices of material events.

Arbitrage Requirements: The City shall comply with federal arbitrage requirements. The Finance Manager shall maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements. The City shall have an arbitrage rebate report prepared for each outstanding bond issue no less than every five years after its date of issuance. The City has contracted with its Financial Advisor to perform the services necessary to monitor arbitrage and to prepare the necessary calculations.

Debt Analysis/Review: A comprehensive analysis/review of all outstanding debt will be performed at least annually in conjunction with the annual budgeting process and determination of the annual property tax levies.

- Debt levels and their related annual costs are important long-term obligations that must be managed within available resources. Effective debt management includes ongoing periodic reviews of the debt portfolio.
- The Finance Manager will ensure that the City's long-term financial planning models for debt are maintained on a current basis, at least annually, reflecting actual historical results, with reasonable forecasting assumptions. Maintaining and reviewing the model on a current basis will help to ensure it remains viable.
- The main objective of these financial models is to provide the City Council and City Manager with current reliable data, reflecting current economic conditions, on which to base decisions and to ensure they remain viable.

Residual Balances: The City will transfer any residual balances in matured debt service funds to the Dept Redemption Fund.

Updates of Policy

The Finance Manager will be responsible for reviewing and amending this policy as dictated by changes in related statutes and bring these updates to the City Council for approval.