Financial Management Policy 7

Debt

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Issued by: Controller/ Assistant Financial Officer

Objective:

The purpose of this policy is to establish parameters and provide guidance governing the issuance of all debt obligations issued by the City of Fort Collins (City).

Applicability:

This debt policy applies to all funds and Service Areas of the City and closely related agencies such as the Downtown Development Authority (DDA), Fort Collins Leasing Corporation and the Fort Collins Urban Renewal Authority (URA).

Authorized by:

City Council Resolutions, 1994-174, 2013-093

7.1 Authorization for Municipal Borrowing

The City Charter (Article V. Part II) authorizes the borrowing of money and the issuance of long term debt. The Charter and State Constitution determine which securities may be issued and when a vote of the electors of the City and approved by a majority of those voting on the issue.

7.2 Purpose and Uses of Debt

Long term obligations should only be used to finance larger capital acquisitions and/or construction costs that are for high priority projects. Debt will not be used for operating purposes. Debt financing of capital improvements and equipment will be done only when the following conditions exist:

a) When non-continuous projects (those not requiring continuous annual appropriations) are desired;
b) When it can be determined that future users will receive a significant benefit from the improvement;
c) When it is necessary to provide critical basic services to residents and taxpayers (for example, purchase of water rights);
d) When total debt, including that issued by overlapping governmental entities, does not

constitute an unreasonable burden to the residents and taxpayers.

7.3 Types of Debt and Financing Agreements

The types of debt permitted are outlined in State statute. The City will avoid derivative type instruments. In general the following debt types are used by the City:

a) General obligation bonds—backed by the credit and taxing power of the City and not from revenues of any specific project. Colorado law limits general obligation debt to 10% of the City's assessed valuation. Under TABOR this type of debt must be approved by voters.

b) Revenue Bonds—issued and backed by the revenues of a specific project, tax increment district (TIF), enterprise fund, etc. The holders of these bonds can only consider this revenue source for repayment. TABOR does not require that voters approve these types of debt.

c) Lease Purchase – issued whereby the asset acquired is used as collateral. Examples include Certificates of Participation (COP), Assignment of Lease Payments (ALP) and equipment leases. TABOR does not require that voters approve these types of agreements.

d) Moral Obligation Pledge—a pledge to consider replenishing a debt reserve fund of another government agency if the reserve was used to make debt payments. This type of commitment will only be used to support the highest priority projects, or when the financial risk to the City does not increase significantly, or when the City's overall credit rating is not expected to be negatively impacted. Because it is a pledge to consider replenishing, it is not a pledge of the City's credit, and as such is not a violation of State statutes and City Charter. However, decision makers should keep in mind that not honoring a Moral Obligation Pledge will almost certainly negatively impact the City's overall credit rating. TABOR does not require that voters approve these types of agreements.

e) Interagency Borrowing—issued when the credit of an agency (DDA, URA) of the City does not permit financing at affordable terms. Usually used to facilitate a project until the revenue stream is established and investors can offer better terms to the agency. Program parameters are outlined in City's Investment Policy. TABOR does not require that voters approve these types of agreements.

f) Conduit Debt—Typically limited to Qualified Private Activity Bonds (PAB) defined by the IRS and limited to the annual allocation received from the State. Low income housing is one example of a qualified use of PAB. There is no pledge or guarantee to pay by the City.

g) Any other securities not in contravention with City Charter or State statute.

7.4 Debt Structure and Terms

The following are guidelines, and may be modified by the City to meet the particulars of the financial markets at the time of the issuance of a debt obligation:

a) Term of the Debt: The length of the financing will not exceed the useful life of the asset or average life of a group of assets, or 30 years, whichever is less. Terms longer than 20 years should be limited to the highest priority projects.

b) Structure of Debt: Level debt service will be used unless otherwise dictated by the useful life of the asset(s) and/or upon the advice of the City's financial advisor.
c) Credit Enhancements: The City will not use credit enhancements unless the cost of the enhancement is less than the differential between the net present value of the debt service without enhancement and the net present value of the debt service with the enhancement.
d) Variable Rate Debt: The City will normally not issue variable rate debt, meaning debt at rates that may adjust depending upon changed market conditions. However, it is recognized that certain circumstances may warrant the issuance of variable rate debt, but the City will attempt to stabilize the debt service payments through the use of an appropriate stabilization arrangement.
e) Derivative type instruments and terms will be avoided.
f) Interest during construction will be capitalized when the debt is in an enterprise fund.

7.5 Refinancing Debt

Refunding of outstanding debt will only be done if there is a resultant economic gain regardless of whether there is an accounting gain or loss, or a subsequent reduction or increase in cash flows. The net present value savings shall be at least 3%, preferably 5% or more. In an advanced refunding (before the call date), the ratio of present value savings to the negative arbitrage costs should be at least 2.

7.6 Debt Limitations and Capacity

Debt capacity will be evaluated by the annual dollar amount paid and the total amount outstanding with the goal to maintain the City's overall issuer rating at the very highest rating, AAA. Parameters are different for Governmental Funds, Enterprise Funds, and Related Agencies.

a. Governmental Funds—Annual debt service (principal and interest) will not exceed 5% of annual revenues. For calculation, revenues will not include internal charges, transfers and large one-time grants. Outstanding debt in relation to population and assessed value will be monitored.
b. Enterprise Funds—Each fund is unique and will be evaluated independently. Each fund's debt will be managed to maintain a credit score of at least an A rating. These funds typically issue revenue bonds and investors closely watch revenue coverage ratio. Coverage ratios are usually published in the Statistical Section of the City's Comprehensive Annual Financial Statement.
c. Related Agencies—Each agency will be evaluated independently, taking into account City Charter, State statutes, market conditions and financial feasibility.

7.7 Debt Issuance Process

When the City utilizes debt financing, it will ensure that the debt is soundly financed by:

a) Selecting an independent financial advisor to assist with determining the method of sale and the selection of other financing team members
b) Conservatively projecting the revenue sources that will be used to pay the debt;
c) Maintaining a debt service coverage ratio which ensures that combined debt service requirements will not exceed revenues pledged for the payment of debt.
d) Evaluating proposed debt against the target debt indicators.

7.8 Other

Debt Management - The City will also have an Administrative Policy and Procedure that includes guidance on:

a) Investment of bond proceeds
b) Market disclosure practices to primary and secondary markets, including annual certifications
c) Arbitrage rebate monitoring and filing
d) Federal and State law compliance practices
e) Ongoing Market and investor relations efforts

Getting Help

Please contact the Controller/Assistant Financial Officer with any questions at 970.221.6772.

Related Policies/References

- The City of Fort Collins Charter (Article V., Part II)

Definitions

Conduit Debt: 1- *An organization, usually a government agency, that issues municipal securities to raise capital for revenue-generating projects where the funds generated are used by a third party (known as the "conduit borrower") to make payments to investors. The conduit financing is typically backed by either the conduit borrower's credit or funds pledged toward the project by outside investors. If a project fails and the security goes into default, it falls to the conduit borrower's financial obligation, not the conduit issuer (City). 2- Common types of conduit financing include industrial development revenue bonds (IDRBs), private activity bonds and housing revenue bonds (both for single-family and multifamily projects). Most conduit-issued securities are for projects to benefit the public at large (i.e. airports, docks, sewage facilities) or specific population segments (i.e. students, low-income home buyers, veterans). 3- In some cases, a governmental entity issues municipal bonds for the purpose of making proceeds available to a private entity in furtherance of a public purpose, such as in connection with not-for-profit hospitals, affordable housing, and many other cases. These types of municipal bonds are sometimes referred to as "conduit bonds." One common structure is for the governmental issuer to enter into an arrangement with the private conduit borrower in which the bond proceeds are loaned to the conduit borrower and the conduit borrower repays the loan to the issuer. For most conduit bonds, although the governmental issuer of the bonds is legally obligated for repayment, that obligation usually is limited to the amounts of the loan repayments from the conduit borrower. If the conduit borrower fails to make loan repayments, the governmental issuer typically is not required to make up such shortfalls. Thus, unless the bond documents explicitly state otherwise, investors in conduit bonds should not view the governmental issuer as a guarantor on conduit bonds.*

Credit Enhancements: *the requirement that a certain percentage or amount of non-federal dollars or in-kind services be provided in addition to the grant funds.*

Interagency: *the individual responsible for fiscally managing the grant award and the person who maintains the records in the City's financial system.*

Debt Service Coverage Ratio: *is a common measure of the ability to make debt service payments. The formula is net operating income (operating revenue – operating expense) divided by debt service (annual principal and interest)*