

MODEL DEBT MANAGEMENT POLICY

Use this model policy as a template in writing a Governmental Entity's policy. This policy is not all-inclusive, but addresses the basic areas and provides guidance concerning best practices as recommended by the Government Finance Officers Association (GFOA). You should review this model and best practices when devising your own policy. Please use the links to GFOA recommended procedures and guidance referenced in the attached bibliography in developing your policy. Policies must be compliant with Federal, State, and Local laws, rules, and regulations ("law").¹

1 INTRODUCTORY SECTION

a Purpose of policy and goals

The policy should begin with a clear statement by the Governmental Entity of the purpose of the debt management policy. If the language in "i" and "ii" below is altered, the Governmental Entity must document the reasoning for the alteration.

- i The purpose of this Debt Management Policy is to provide the Governing Body with written guidelines and restrictions:
 - for use in the capital planning funding decision to determine the amount and type of debt to be issued, in the debt issuance process (including to determine the acceptable level of risk for a debt transaction), and in the management of debt;
 - to provide limits:
 - on the amount of debt outstanding and on the amount of annual debt service;
 - on the use of and justification for variable-rate debt;
 - on the use of and justification for debt structures other than level principal or level debt service;
 - on the maximum maturities of debt;
 - on the timing of principal and interest payments;
 - on the use of credit enhancements; and
 - on the use of debt related derivatives;
 - to improve the quality of decisions, provide the basis for determination of the structure of debt, to identify policy goals, and to demonstrate a commitment to long-term financial planning, including a multi-year capital plan;
 - to serve as a public commitment by the Governing Body to manage the financial affairs of the Governmental Entity so as:
 - to minimize legal risks by complying with all law while planning debt transaction, executing them, and throughout the life of the debt transaction;
 - to minimize the financial risk to current and future budgets especially the risk associated with delayed principal payment

¹ Federal includes the Securities and Exchange Commission, Municipal Securities Rulemaking Board, Internal Revenue Service, etc. Any reference in this policy to "law" includes all of these levels.

debt structures, variable-rate interest, and debt related derivatives;

- to maximize future debt capacity;
 - to maintain access to the local, regional and national credit markets;
 - to minimize the financing cost of capital projects at the lowest level of risk;
 - to provide all disclosures required by law;
 - to adopt and adhere to financial management policies including debt and derivative management policies as a signal to the rating agencies, capital markets, and citizens that the Governmental Entity shall be well managed and meet obligations in a timely manner; and
 - to promote sound financial management by finance staff through the definition and assignment of authority and responsibilities and to give the Governing Body a tool to measure the performance of finance staff.
- to provide for public accountability and transparency as it relates to:
 - the selection of and payment for professional services related to the issuance of debt;
 - the avoidance of conflicts of interest;
 - full disclosure of all proposed and actual costs², to citizens, the Governing Body, investors, regulators and other government officials; and
 - the debt financing decision, implementation, and maintenance.

ii The goals for this Debt Management Policy are:

- to identify and comply with all law related to debt issuance and management;
- to have citizens and stakeholders informed of contemplated and outstanding debt and all costs proposed and actual;
- to minimize the use of short-term cash flow borrowings³ by maintaining adequate working capital⁴ and authorizing only the minimum amount required to offset mismatches between available cash and cash outflows determined by cash flow analysis;
- to issue debt to finance projects only which are included in the Governmental Entity's Capital Improvement Plan, or Economic Development Plan;
- to establish criteria to determine any use of general obligation debt, revenue and tax debt, revenue debt, conduit debt, short-term debt, and capital leases;
- to establish criteria for the use of pay-as-you go financing versus debt financing;

² Cost of issuance, interest cost, continuing, one-time costs, etc.

³ Tax and Revenue Anticipation Notes.

⁴ Cash.

- to establish the maximum life, or the criteria for establishing the maximum life, of a debt transaction;
- to minimize interest costs at the lowest level of financial risk to operations;
- to assess and mitigate debt portfolio risks⁵ to the Governmental Entity's short and long term operations;
- to address arbitrage related risks particularly those related to fund balances;
- to provide for sound financial guidance to staff;
- to achieve a debt portfolio structured with 65% (but not less than 50%) of principal repaid in ten (10) years; and
- to move the Governmental Entity toward achieving both the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting and the Distinguished Budget Presentation Award.

b Purposes for which debt may be issued:

The Governmental Entity should decide which projects⁶ or type of projects may be funded with debt and the conditions under which debt can be issued for working capital. (Working Capital debt shall only be used where specific statutory authority exists.)

- i Projects: Debt shall only be issued for Projects⁷ identified in the Capital Improvement Plan or Economic Development Plan that the Governing Body has previously determined to fund with debt financing.⁸
 - ii Working capital
 - 1) Debt shall only be issued for working capital for operations after cash flow analysis has determined that there is a mismatch between available cash and cash outflows.
 - 2) Working capital debt shall be repaid by the end of the fiscal year in which the debt was incurred.
- c Limitations on indebtedness- Debt Service, Outstanding Debt, Permitted Debt Structures
- i Legal limits: The Governmental Entity shall not exceed limits on outstanding debt and annual debt service payments as required by statute. The legal limit on outstanding debt is _____. The legal on annual debt service is _____.⁹
 - ii Public policy limits¹⁰

⁵ Particularly those related to delayed principal payment debt structures, variable-rate interest; and debt related derivatives through the use of a debt and derivatives management report

⁶ Policy determinations concerning the type of projects for which debt financing may be used should be in the Governmental Entity's Capital Planning Policy. Projects must be reviewed to confirm specific statutory authority for funding by the issuance of debt.

⁷ Projects – These are defined in the State statutes authorizing debt and should be defined in the Governmental Entity's capital planning policies to include items such as police cars, fire trucks, ambulances, etc that a Governmental Entity wishes to fund using debt financing.

⁸ Criteria may need to be developed to use debt financing for equipment and other items that are capital items but not included in the Capital Improvement Plan or Budget.

⁹ In the annual debt management report, the statutory limits for debt shall be listed with the current outstanding balance on all outstanding debt. If there is no specific statutory limit, this information will still be reported.

- 1) *(If the Governing Body decides to prohibit the use of any type of debt or for a particular purpose, the prohibition should be included here.)*
 - 2) Debt may only be issued for projects included in the current year's Capital Budget.
 - 3) The maximum amount of variable rate debt may not exceed 25% of the outstanding debt.¹¹
 - 4) The last maturity of debt issue may not be more than 25 years with a goal maturity of 20 years.¹²
 - 5) Debt may be issued for economic development only if an independently performed feasibility study showing the benefits outweigh the costs of the project to the Governmental Entity attested by a public accountant.
- iii Structure limits:
- 1) The Governmental Entity shall determine the useful life of an asset to insure the life of asset is equal or greater the last maturity of a proposed debt issue.
 - 2) Principal amount of debt issued shall size debt not exceed estimated project costs and costs of issuance; except for the construction period of projects using revenue or general obligation backed revenue as a security, those may capitalize interest for up to three years during the construction period of a revenue-producing project.

iv Financial limits¹³

Financial limits generally reflect public policy or other financial resource constraints, such as reduced use of a particular type of debt due to changing financial conditions. Appropriate debt limits can positively influence bond ratings, if the Governmental Entity demonstrates adherence to such policies over time. Financial limits are often expressed as ratios customarily used by credit analysts. Different financial limits are used for different types of debt. The Governmental Entity should determine financial limits to use as a guide in issuing debt and determining the affordability of debt.

¹⁰ Any variation or alteration in (2) through (5) requires documentation as to justification and will require use of a financial advisor in those transactions.

¹¹ Justification is required for any variable debt ratio beyond 25% of the outstanding debt. A Financial Advisor must be involved when a debt issue will cause the 25% ratio of debt to be exceeded.

¹² Justification is required for any maturity beyond 25 years. A Financial Advisor must be involved when proposed maturities are beyond 25 years

¹³ Examples include:

- o *Direct Debt* can be measured or limited by the following ratios:
 - Debt per capita,
 - Debt to personal income,
 - Debt to taxable property value, and
 - Debt service payments as a percentage of general fund revenues or expenditures.
- o *Revenue Debt* levels are often limited by debt service coverage ratios (e.g., annual net pledged revenues to annual debt service) or credit rating impacts (e.g., additional bonds should not lower ratings) contained in bond covenants.
- o *Conduit Debt* limitations may reflect the right of the Governmental Entity to approve the borrower's creditworthiness, the purpose of the borrowing issue, or a minimum credit rating. Such limitations reflect sound public policy, particularly if there is a contingent impact on the general revenues of the Governmental Entity or marketability of the Governmental Entity's direct debt.
- o *Short-Term Debt Issuance* should describe the specific purposes and circumstances under which it can be used, as well as limitations in term or size of borrowing.

- d Credit objectives (if rated)
 - i The Governmental Entity shall seek to maintain and improve its current long-term rating of ___ from Fitch, ___ from Moody's, and ___ from Standard & Poors.
 - ii The Governmental Entity shall seek to maintain and improve its current short-term rating of ___ from Fitch, ___ from Moody's, and ___ from Standard & Poors.
 - iii The Governmental Entity shall use credit enhancement only when a significant savings is produced through its use or when necessary for marketing reasons.¹⁴
- e Types of debt
 - i Source of debt payment (Security)¹⁵
The Governmental Entity should determine the source of revenue for debt service payments and the purposes that it may be pledged.
 - ii Debt instruments¹⁶
Select permissible debt instruments.
- f Risk assessment
 - i Risk assessment on the effect of the outstanding debt portfolio shall be performed annually and presented to the Governing Body as part of the annual budget approval process in a debt and derivatives management report. Risk assessment is done to determine the impact of the debt portfolio on current and future operations. In the annual debt management report, the statutory limits for debt shall be listed with the current outstanding balance on all outstanding debt. If there is no specific statutory limit, this information will still be reported.

¹⁴ When credit enhancement is used, a determination of what a significant savings is must be made by the Governmental Entity and a Financial Advisor engaged for the transaction.

¹⁵ For example:

1. General Obligation¹⁵
2. Tax & Revenue
3. Special Assessment
4. Tax Increment Financing
5. Revenue
6. Appropriations (Lease Only)
7. Grants (Hybrid Security – Grant and General Obligation Pledge)

¹⁶ For example:

1. Bonds
2. Notes
3. Commercial Paper
4. Lines of Credit
5. Loan Agreements (Conduit Debt)
6. Interfund Loans (Notes)
7. Capital Leases
8. Conduit Debt Federal Loan Programs
9. State Revolving Fund
10. Tennessee Local Development Authority
11. State School Bonding Authority
12. TECD Local Government Energy Efficiency Loan Program
13. TDOT Utility Relocation Loan Program
14. Qualified Zone Academy Bond Program

- ii Risk assessment on the effect of planned debt issuance shall be performed as part of the debt planning process. The assessment shall be presented to the Governing Body prior to any approval meeting. Risk assessment is done to determine the impact of the change in the debt portfolio on current and future financial operations and position.

2 LEGAL SECTION

- a In the issuance and management of debt, the Governmental Entity shall comply with law. The Governing Body shall require the financial staff and Governmental Entity's attorney to be familiar with the applicable constitutions, charters, laws, rules, and regulations and report the effects on planned and outstanding debt.
- b At least annually, the financial staff, Governmental Entity's attorney or bond counsel with a client relationship strictly with the Governmental Entity shall review and report to the Governing Body any changes in law and their effect on the issuance and/or management of debt.
- c During the planning stages of any debt issue, the Governing Body shall be informed by the financial staff, Governmental Entity's attorney or bond counsel with a client relationship strictly with the Governmental Entity of the current law effecting the issuance of planned debt and management of the debt portfolio.

3 ACCOUNTABILITY AND TRANSPARENCY

The Governmental Entity shall comply with legal requirements for notice and for public meetings related to debt issuance¹⁷. In the interest of transparency, all costs (whether interest, issuance, continuing, or one-time) shall be disclosed to the citizens, governing body, and other stakeholders in a timely manner¹⁸. During the issuance process, a method must be developed to disclose cost and other information. The Debt and Derivative Management Report must be used to report this information on a continuing basis.

4 PROFESSIONAL SERVICES SECTION

This section defines professional services to be used, establishes the selection process, and specifies the required conflict of interest provisions. The Governmental Entity must set policies for the service providers participating in a debt transaction. This is not an exhaustive list of professionals. Insert any predetermined requirements (such as must have a Tennessee office).

- a All Transactions
 - i Financial Advisor ("FA")¹⁹
 - 1) Selection

¹⁷ The Governmental Entity should include specific time information concerning public notice for debt transactions, whether required by law or self-imposed (particularly if the Governmental Entity has determined to provide greater notice period than is required by law).

¹⁸ It is recommended that the disclosure form(s) required by Tennessee Code Annotated Section 9-21-151 (to disclosure actual costs) be used to provide disclosure of proposed costs of a debt transaction.

¹⁹ "Financial Advisor" means an individual or entity that provides advisory services with experience in the area of debt transactions for issuers of municipal debt. A Financial Advisor is required for the following debt transactions:

- a. whose final maturity is greater than 25 years from the date of issuance;
- b. that cause the ratio of variable-rate debt to increase beyond level set in Section ;
- c. that are not at least level debt amortization;
- d. that use any type of credit enhancement;
- e. involving an underwriter; or
- f. involving the use of a derivative.

- a) The Financial Advisor must have documented experience in providing financial advisory services for the Governmental Entity or comparable issuers, and for financings of similar size, types and structures.
 - b) The Financial Advisor is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.²⁰
 - c) The Financial Advisor is to be retained prior to planning a transaction.
- 2) Terms of contract
- The Governmental Entity must decide whether to retain the Financial Advisor for a single debt transaction or for period of time.*²¹
- a) This relationship shall be for _____.
 - b) The Financial Advisor's performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.
- 3) Conflict of Interest
- a) The Financial Advisor's fiduciary duty in a transaction or for the contract period **shall strictly** be only to the Governmental Entity.
 - b) The Financial Advisor shall not bid on an issue for which they are providing advisory services²².
 - c) The Financial Advisor must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors may not serve as the Financial Advisor to the Governmental Entity who is the borrower.
 - d) The Financial Advisor must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Bond Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
 - e) The complete conflict of interest information disclosure shall be presented by _____²³ to the Governing Body in a public meeting.
 - f) The Financial Advisor shall agree to refrain from entering into any relationship that would give rise to a conflict of interest during the contract period. Any failure to comply with this anti-conflict provision will result in the termination of the advisory contract.
 - g) If the Financial Advisor serves as an investment advisor, the Financial Advisor must be registered with the SEC as an Investment Advisor and

²⁰ Use GFOA Recommended Procedure: *Selecting Financial Advisors (2008) (DEBT)* to design procedure.

²¹ The Governmental Entity must not permit a firm to resign as Financial Advisor and to become the Underwriter on a transaction. The Entity must decide whether to permit a Financial Advisor to serve as Underwriter on a separate and distinct transaction. The Entity must decide whether to impose a "lock-out period" after the end of a contract before the Financial Advisor could serve as an Underwriter. These items must be addressed in this policy section.

²² See footnote above.

²³ Insert the assigned staff person or position.

shall hold a series 65 or 66 license and not be involved in the brokering of investment products connected to an advised debt issue.

ii Issuer's Counsel²⁴

1) Selection

- a) The Issuer's Counsel must have documented experience in providing legal advice for the Governmental Entity or comparable issuers, related to financings of similar size, types and structures, including financings in Tennessee.
- b) The Issuer's Counsel is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.²⁵
- c) The Issuer's Counsel is to be retained prior to any formal action on a transaction.

2) Terms of contract

The Governmental Entity must decide whether to retain the Issuer's Counsel for a single debt transaction or for period of time.

- a) This relationship shall be for _____.
- b) The Issuer's Counsel's performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.

3) Conflict of Interest

- a) The Issuer's Counsel's sole client relationship governed by ethical rules in a transaction must strictly be only to the Governmental Entity. No waiver of any conflict of interest with respect to representations of multiple parties in the same transaction will be permitted.
- b) The Issuer's Counsel may serve as Bond Counsel.
- c) The Issuer's Counsel must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors may not serve as the Issuer's Counsel to the Governmental Entity who is the borrower.
- d) The Issuer's Counsel must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Bond Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
- e) The complete conflict of interest information disclosure shall be presented by _____²⁶ to the Governing Body in a public meeting.

²⁴ The intent is to select an Issuer's Counsel, an entity or individual who has legal experience and expertise in the area of municipal finance transactions and whose sole client relationship governed by ethical rules in a transaction(s) **must strictly** be only to the Governmental Entity, on a competitive merit basis for those transactions the Government does not have in-house staff or sufficient in-house expertise.

²⁵ Use GFOA Recommended Procedure: *Selecting Bond Counsel (1998 and 2008) (DEBT)* to design procedure.

²⁶ Insert the assigned staff person or position.

- f) The Issuer’s Counsel shall agree to refrain from entering into any relationship that would give rise to a conflict of interest during the contract period. Any failure to comply with this anti-conflict provision will result in the termination of the contract.
- iii Bond Counsel²⁷
- 1) Selection
 - a) Bond Counsel must have documented legal experience and expertise in the area of municipal finance transactions for the Governmental Entity or comparable issuers, related to financings of similar size, types and structures.
 - b) The Bond Counsel is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.²⁸
 - c) The Bond Counsel is to be retained prior to any formal action on a transaction.
 - 2) Terms of contract

The Governmental Entity must decide whether to retain the Bond Counsel for a single debt transaction, for an Indenture or Program, or for period of time.

 - a) This relationship shall be for _____.
 - b) The Bond Counsel performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.
 - 3) Conflict of Interest
 - a) Bond Counsel’s sole client relationship governed by ethical rules in a transaction must strictly be only to the Governmental Entity. No waiver of any conflict of interest with respect to representations of multiple parties in the same transaction will be permitted.
 - b) Bond Counsel may serve as Issuer’s Counsel and Swap Counsel.
 - c) Bond Counsel must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors may not serve as the Bond Counsel to the Governmental Entity who is the borrower.
 - d) Bond Counsel must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Issuer’s Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.

²⁷ “Bond Counsel” shall mean an individual or entity who has legal experience and expertise in the area of municipal finance transactions. In the case of a conduit financing, the conduit issuer’s staff, consultants and contractors (including Bond Counsel) shall not serve as the counsel to the Governmental Entity borrower which is borrowing from or through the conduit issuer. The Bond Counsel may serve also as the Governmental Entity’s Swap Counsel.

²⁸ Use GFOA Recommended Procedure: *Selecting Bond Counsel (1998 and 2008) (DEBT)* to design procedure.

- e) The complete conflict of interest information disclosure shall be presented by _____²⁹ to the Governing Body in a public meeting.
 - f) Bond Counsel shall agree to refrain from entering into any relationship that would give rise to a conflict of interest during the contract period. Any failure to comply with this anti-conflict provision will result in the termination of the contract.
- iv Paying Agent
 - v Disclosure Agent
- b Negotiated Sale
 - i Underwriter
 - 1) Selection
 - a) The Underwriter shall not serve as the Financial Advisor to a Governmental Entity in the same debt or derivative transaction. A Financial and/or Swap Advisor cannot resign and become the Underwriter in a debt transaction
 - b) The Underwriter must not be selected until after a Financial Advisor has been engaged for the debt transaction.
 - c) The Underwriter must have documented experience in underwriting debt for the Governmental Entity or comparable issuers, and for financings of similar size, types and structures.
 - d) The Underwriter is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process, with the assistance of the Financial Advisor.³⁰
 - 2) Terms of contract

*The Governmental Entity must decide whether to retain the Underwriter for a single debt transaction or for period of time.*³¹

 - a) This relationship shall be for _____.
 - b) The Underwriter's performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.
 - 3) Conflict of Interest
 - a) The Underwriter must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the underwriter for the conduit issuer may not serve as the Financial Advisor to the Governmental Entity who is the borrower.
 - b) The Underwriter must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Bond Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty,

²⁹ Insert the assigned staff person or position.

³⁰ Use GFOA Recommended Procedure: *Selecting Underwriters for Negotiated Bond Sales (2008)(DEBT)* to design procedure.

³¹ The Governmental Entity must not permit a firm to resign as Financial Advisor and to become the Underwriter on a transaction. The Entity must decide whether to permit a Financial Advisor to serve as Underwriter on a separate and distinct transaction. The Entity must decide whether to impose a "lock-out period" after the end of a contract before the Financial Advisor could serve as an Underwriter. These items must be addressed in this policy section.

- and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
- c) The complete conflict of interest information disclosure shall be presented by _____³² to the Governing Body in a public meeting.
- ii Underwriter's Counsel
 - 1) Selection
 - a) The Governmental Entity reserves the right to approve the Underwriter's selection of counsel.
 - b) The Governmental Entity reserves the right to draw up a list of general qualifications or a list of acceptable firms for an underwriter to select counsel.³³
 - 2) Conflict of Interest
 - a) The Underwriter's Counsel must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the Underwriter's Counsel for the conduit issuer's Underwriter may not serve as the Counsel (Bond, Swap or Issuer's) to the Governmental Entity who is the borrower.
 - b) The Underwriter's Counsel must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Bond Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
 - c) The complete conflict of interest information disclosure shall be presented by _____³⁴ to the Governing Body in a public meeting.
- c Forward Purchase Agreements/Derivatives³⁵
 - i Swap Advisor
 - 1) Selection
 - a) Swap Advisors must have documented experience in providing swap or derivative advisory services for the Governmental Entity or comparable issuers, and for financings of similar size, types and structures.
 - b) The Swap Advisor is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.³⁶
 - c) The Swap Advisor is to be retained prior to planning a transaction.
 - 2) Terms of contract

*The Governmental Entity must decide whether to retain the Swap Advisor for a single debt transaction or for period of time.*³⁷

³² Insert the assigned staff person or position.

³³ Please refer to GFOA Recommended Procedure: *Issuer's Role in Selection of Underwriter's Counsel (1998)*

³⁴ Insert the assigned staff person or position.

³⁵ Include only if permit use.

³⁶ Use GFOA Recommended Procedure: *Selecting Financial Advisors (2008) (DEBT)* to design procedure.

- a) This relationship shall be for _____.
 - b) The Swap Advisor's performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.
- 3) Conflict of Interest
- a) Swap Advisor's fiduciary duty in a transaction or for the contract period **shall strictly** be only to the Governmental Entity.
 - b) Swap Advisors shall not bid on the underlying debt issue for which they are providing advisory services³⁸.
 - c) The Swap Advisor must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors may not serve as the Swap Advisor to the Governmental Entity who is the borrower.
 - d) The Swap Advisory must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Underwriter's Counsel, Bond Counsel, Swap Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
 - e) The complete conflict of interest information disclosure shall be presented by _____³⁹ to the Governing Body in a public meeting.
 - f) The Swap Advisor shall agree to refrain from entering into any relationship that would give rise to a conflict of interest during the contract period. Any failure to comply with this anti-conflict provision will result in the termination of the advisory contract.
 - g) If the Swap Advisor serves as an investment advisor, the Swap Advisor must be a registered with the SEC as an Investment Advisor and shall hold a series 65 or 66 license and not be involved in the brokering of investment products connected to an advised debt issue.
- ii Swap Counsel
- 1) Selection
 - a) Swap Counsel must have documented legal experience and expertise in the area of municipal finance and derivative or swap transactions for the Governmental Entity or comparable issuers, related to financings of similar size, types and structures.
 - b) The Swap Counsel is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.⁴⁰

³⁷ The Governmental Entity must not permit a firm to resign as Swap Advisor and to become the Underwriter on a transaction. The Entity must decide whether to permit a Swap Advisor to serve as Underwriter on a separate and distinct transaction. The Entity must decide whether to impose a "lock-out period" after the end of a contract before the Swap Advisor could serve as an Underwriter. These items must be addressed in this policy section.

³⁸ See footnote above.

³⁹ Insert the assigned staff person or position.

- c) The Swap Counsel is to be retained prior to any formal action on a transaction.
- 2) Terms of contract

The Governmental Entity must decide whether to retain the Swap Counsel for a single derivative or swap transaction, for an Indenture or Program, or for period of time.

 - a) This relationship shall be for _____.
 - b) The Swap Counsel performance shall be reviewed at least annually for multi-year contracts and as part of the after sale evaluation for transactions.
- 3) Conflict of Interest
 - a) Swap Counsel's sole client relationship governed by ethical rules in a transaction must strictly be only to the Governmental Entity. No waiver of any conflict of interest with respect to representations of multiple parties in the same transaction will be permitted.
 - b) Swap Counsel may serve as Issuer's Counsel and Bond Counsel.
 - c) Swap Counsel must disclose all relationships (including fees and payments) to any other transaction participant outside of the transaction. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors may not serve as the Swap Counsel to the Governmental Entity who is the borrower.
 - d) Swap Counsel must fully disclose all existing client and business relationships between and among the professionals to a transaction (including but not limited to Financial Advisor, Swap Advisor, Issuer's Counsel, Bond Counsel, trustee, paying agent, underwriter, Counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall extend to any existing or known future relationships or representations that could give rise to, or the appearance of, a conflict of interest.
 - e) The complete conflict of interest information disclosure shall be presented by _____⁴¹ to the Governing Body in a public meeting.
 - f) Swap Counsel shall agree to refrain from entering into any relationship that would give rise to a conflict of interest during the contract period. Any failure to comply with this anti-conflict provision will result in the termination of the contract.

5 ISSUANCE SECTION

a Structuring

When determining the structure of a debt obligation as a policy the following should be considered in developing debt structure policy:

i Form

- 1) Determine Type of Security (General Obligation, Revenue, etc.) and lien position.
- 2) Tax status: Debt transaction shall be structured as tax-exempt unless the constraints imposed justify the increased cost of a taxable transaction.

⁴⁰ Use GFOA Recommended Procedure: *Selecting Bond Counsel (1998 and 2008)(DEBT)* to design procedure.

⁴¹ Insert the assigned staff person or position.

3) Maturity: Debt transaction shall be structured with a maximum maturity of 25 years; however, if a maturity beyond 25 years is necessary, then the Governmental Entity shall use a financial advisor for the transaction.⁴²

4) Determine Type of Debt Instrument

ii Sizing

Determine costs that can be included in the principal amount of debt, including construction interest. If revenue debt, determine whether debt service reserve fund will be funded with debt proceeds rather than other funds. Determine whether will permit expenditure of funds in advance of debt issuance/reimbursement resolutions.

1) Maturity Structure/Principal Payment

- a) The Governmental Entity will use level principal payment or level debt service as the primary structure for repayment of debt. If any other structure is selected, the Governmental Entity will use a Financial Advisor.
- b) For revenue producing projects the Governmental Entity may defer repayment of principal during the construction period and for six (6) months afterwards.
 - i) Any spend down election shall be presented to the Governing Body at the time of approval of the debt.

2) Interest Rate

- a) Fixed rate debt may be used with all types of debt structures.
- b) Variable rate debt.

Determine when the use of variable rate debt is justified. An acceptable risk level for the use of variable rate debt must be determined. In addition, these two provisions must be included in the policy:

- i) A risk assessment and a determination of the operational requirements to monitor and maintain the proposed variable rate debt structure shall be made in determining whether the potential benefits outweigh the potential costs (including in the worst-case scenario) in using this structure. A stress test looking at performance of the debt instrument at various interest rates and in the situation where the instrument fails (for example, in remarketing) shall be performed. The results of the assessment shall be presented to the Governing Body at a public meeting and made available for public inspection.
- ii) The Governmental Entity has set 25% of total outstanding debt as the maximum level of total outstanding debt that can be in any form of variable rate. In order to reset the level above 25%, the Governmental Entity shall first determine the risk to its current and future financial operations and position based on analysis by a Financial Advisor. The Governmental Entity shall use a Financial Advisor for any debt transaction any time the total outstanding debt level for any form of variable rate debt will be in excess of 25%.

⁴² It is recommended that Governmental Entities establish a goal of 20 year maximum maturity for debt transactions.

- c) Synthetic debt (variable-to-fixed and/or fixed-to-variable interest rate agreements). *(Optional, requires the adoption of a derivative policy)*

Determine criteria that justify use of synthetic debt and determine acceptable levels of risk for this type of debt instrument.

b Method of Sale

The Governmental Entity must determine whether it legally has discretion in the selection of method of sale. If there is discretion, the Governmental Entity must determine what factors will be used when determining the method.

i Competitive

Tennessee law has a preference or presumption that competitive is the method to use UNLESS facts justify a different method. Establish criteria to determine the bid parameters and basis on which award of debt will be made.

ii Negotiated

Establish criteria to be used to determine:

- *when the use of negotiated sale is justified over competitive, such as when there is market uncertainty or the credit is complex (story bond); and*
- *selling group and syndicate structure and requirements (order periods, spread components, etc).*

iii Private Placement

Determine when the use of private placement is justified over competitive or negotiated sale.

c Credit Rating

This section should be drafted to achieve rating goals established earlier in this policy.

d Documentation and Initial Disclosure

The Governmental Entity should consult with its Issuer's and Bond Counsel to determine documentation and initial disclosure requirements based on legal requirements. Staff should be assigned responsibility for preparation. A policy should be developed to ensure compliance and adequate disclosure is made.

e Credit Enhancement

Determine when use of credit enhancements is permitted.

f Use of Debt Related Derivatives

Determine when to use debt related derivatives for a particular debt issue.

- i The use of Interest Rate Agreements are not permitted if: (i) the rationale for using the agreement is based predominantly on speculation regarding the future direction or level of interest rates; (ii) the fair market value of the transaction cannot be readily and reliably determined at all times by the Governmental Entity or its agents; (iii) the transaction structure and/or terms result in a lack of liquidity and the inability to timely terminate the transaction at a market price; (iv) the transaction is inconsistent with this Debt and Derivative Management Policy.

- ii The ____ shall present to the Governing Body an explanation of the risks and potential mitigation efforts related to a proposed Agreement prior to seeking a Letter of Compliance with the State Funding Board Guidelines.

g Risk Assessment

Determine impact of any proposed debt issue using stress testing on debt portfolio and Governmental Entity's Financial Operations and Position determining acceptable level of risk compared to benefit.

6 MANAGEMENT AND MONITORING SECTION

a Post-Sale

i After sale evaluation⁴³

- 1) Immediately after the sale of debt, the process and outcome of the transaction will be evaluated. This evaluation will contain at a minimum:
 - a) Market conditions at the time of sale or pricing;
 - b) An evaluation of all borrowing costs including underwriting spread and a comparison of rates on the Governmental Entity's debt with similar issues;
 - c) For a negotiated sale, an analysis of the performance of the syndicate members/firm(s) selling the debt;
 - d) A review of investors buying the debt; and
 - e) Observations of the secondary market activity on the debt for two weeks following the sale or pricing of the debt.
- 2) The Governmental Entity shall retain documentation of pricing of the bonds, pre-sale and post-sale data.
- 3) The after sale evaluation shall be completed no later than 30 days after the sale and presented by _____⁴⁴ to the Governing Body in at its next public meeting.

ii Investment of Debt Proceeds⁴⁵

- 1) Debt proceeds shall be invested to prevent the loss of principal (safety), maximize liquidity, and to maximize yield without risk to safety or liquidity. Safety shall be the preeminent principal in the investment of debt proceeds with liquidity being second.
- 2) Debt proceeds shall be invested in accordance with the requirements of law, particularly tax law requirements.
- 3) Investments shall be purchased at a fair market price.
- 4) Cash flow projections shall be made in determining project cash requirements in determining which permitted investments shall be used.
- 5) The maximum maturity for the investment proceeds shall be one year with maturity being determined by cash flow needs.
- 6) Adequate records shall be maintained to comply with arbitrage rebate requirements.
- 7) All fees associated with investments shall be fully disclosed and reported to the Governing Body.
- 8) Underwriters and the Financial Advisor shall report any finder's fees or fee-sharing arrangements as well as any conflicts of interest that may arise from the investment of bond proceeds.
- 9) An investment officer shall be appointed to perform regular and ongoing monitoring of the custody and investment of debt proceeds.

- iii The Governmental Entity shall develop procedures to ensure that sale related reporting requirements⁴⁶ are met within the required times.

⁴³ *A Practitioner's Guide: Pricing Bonds in a Negotiated Sale – How to Manage the Process*, GFOA 1994

⁴⁴ Staff member assigned.

⁴⁵ GFOA Recommended Practice: *Investment of Bond Proceeds (1996 and 2007) (DEBT and CASH)*.

⁴⁶ Whether to the State, MSRB, IRS, or other required entities.

- iv The Governmental Entity shall notify the Underwriters of any fact or event that might cause the official statement to contain any untrue statement of material fact or omit to state a material fact necessary to make the statements therein, in light of the circumstance they were made, not misleading for 90 days after the signing of the Bond Purchase Agreement.
- b Project Compliance
 - i The Governmental Entity shall not permit private business use in facilities constructed using tax-exempt debt except as specifically disclosed prior to sale of debt or as subsequently opined by nationally recognized Bond Counsel to not impact the tax-exempt status of the debt.
 - ii Debt proceeds shall be expended within the legally allowable construction period and accounted for in a manner that allows project expenditures to be traced to debt proceeds to show compliance with legal requirements.
 - iii Documents related to a debt issue shall be retained for the life of an issue or the life of the refunding of the issue plus three years.
- c Continuing Disclosure Compliance
 - i For each debt issue requiring continuing disclosure under Securities and Exchange Commission Rule 15c2-12 a staff member or a contracted dissemination agent shall be named to be responsible for the required reporting.
 - ii A staff member shall monitor required reporting dates to ensure annual and periodic reporting requirements are satisfied.
 - iii Bond counsel shall be consulted to determine requirements for disclosure to use in developing procedures.
 - iv Compliance status shall be reported annually to the Governing Body at a public meeting.
- d Arbitrage Compliance
 - i The Governmental Entity shall use an Arbitrage Consultant to determine compliance and rebates.
 - 1) An Arbitrage Consultant must have documented experience in providing arbitrage services.
 - 2) An Arbitrage Consultant is to be selected either by a Competitive Request for Proposal (RFP) or Qualification (RFQ) process.
 - 3) The Arbitrage Consultant shall be select during the debt issue planning process.
 - ii Record keeping and retention procedures shall be determined in consultation with a Bond Counsel possessing the appropriate experience in IRS requirements.
 - iii Procedures shall be developed to monitor and report arbitrage, yield burning, and Debt Service Reserve compliance.
 - iv Reporting shall comply with legal requirements.
 - v Compliance status shall be reported annually to the Governing Body at a public meeting.
- e Continuing Risk Assessment and Debt Portfolio Monitoring
 - i The Governmental Entity's risk tolerance for fixed, variable-rate, and synthetic debt is _____.
 - ii The Governmental Entity's shall monitor for actual and potential debt portfolio (fixed, variable-rate, and synthetic debt) impact on Governmental Entity

Financial Operations and Position. The annual debt and derivatives management report should be used for this assessment during the annual budget process.⁴⁷

- iii Risk mitigation procedures shall be developed based on the level risk tolerance and type of debt instruments.
- f Refunding Debt
 - i Staff should monitor refunding opportunities at least quarterly.
 - ii Refunding opportunities shall be reported to the Governing Body if net present value savings of 4% or more can be achieved.
 - iii Refunding opportunities should be reported for revenue debt if restrictive covenants prevent the issuance of other debt or create other restrictions on the financial management of revenue producing activities.
 - iv Comprehensive costs information associated with a refunding shall reported to the Governing Body as well a complete plan of refunding detailing the costs and benefits of each option prior to a comprehensive plan of refunding being submitted to the Director of Local Finance.

7 **DERIVATIVE POLICY** *(language to come)*

Include only if debt related derivative structures are permitted in policy.

⁴⁷ Debt and Derivative Management Report shall mean a written management report of the Governmental Entity including, but not limited to, the following:

Debt

1. A listing of each outstanding obligation by type and disclosing amount initially authorized, outstanding amount, interest rate for current year fixed rate debt, actual basis for variable rate debt, principal and interest payment for the coming budget year, outstanding principal amount at end of coming budget year, and fund of payment;
2. Total amount of debt of the Governmental Entity by fund, by type, and by security;
3. Total amount of variable rate debt of the municipality with percent of variable rate debt by fund, by type, by security, and by total outstanding debt;
4. Analysis of the effect of rising interest rates on variable rate holdings of the Governmental Entity including impact on financial condition and position;
5. Analysis of risk in maintaining variable risk holdings on financial condition and position;
6. Analysis of debt portfolio principal and interest payments on next five years projected budgets; and
7. Governmental Entity's documentation of its compliance with its debt policy for the fiscal year.

Derivatives:

1. Analysis of the impact of outstanding Interest Rate Agreements on the prior year's financial condition and position of the Governmental Entity;
2. Analysis of the impact of outstanding Interest Rate Agreements payments on the coming budget year with stress testing for risks associated with the Interest Rate Agreements and changes in market conditions;
3. Analysis of the impact of basis risk on transaction;
4. Analysis of early termination, involuntary termination, default, and cost considerations associated with outstanding Interest Rate Agreements;
5. Analysis of hedge effectiveness;
6. Summary of monitoring for all outstanding Interest Rate Agreements in the prior year;
7. Update on method and assumptions for determining market/termination value and any other estimates or rates associate with Interest Rate Agreements; and
8. Governmental Entity's documentation of its compliance with its derivative policy for the fiscal year.

8 **REVIEW**

a This policy shall be reviewed _____.⁴⁸

9 **HISTORY:** Public Hearing Dates/Adoption Date/Effective Dates/Review Dates

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⁴⁸ The review must occur at least once every two years and upon any change or vacancy in the positions of CEO or CFO.

Bibliography

1. Comptroller of the Treasury
 - Guide For The Issuance Of Notes By The Counties, Consolidated Governments, Aand Municipalities Of Tennessee (www.tn.gov/comptroller/lf/pdf/guide2003.pdf)
2. Government Finance Officers Association (GFOA) Recommended Practices (www.gfoa.org)

Governmental Debt Management

- [Analyzing an Advance Refunding](#) (1995)
- [Payment of the Expense Component of Underwriters' Discount](#) (1996)
- [Sale and Securitization of Property Tax Liens](#) (1997)
- [Using Variable Rate Debt Instruments](#) (1997)
- [Issuer's Role in Selection of Underwriter's Counsel](#) revised (1998, 2009)
- [Issuing Taxable Debt by U.S. State and Local Governments](#) (1998)
- [Underwriter Disclaimers in Official Statements](#) (2000)
- [Using a Web Site for Disclosure](#) (2002)
- [Debt Management Policy](#) (1995, 2003)
 - [Post Issuance Compliance Checklist](#)
- [Maintaining an Investor Relations Program](#) (1996, 2003)
- [Evaluating the Use of Pension Obligation Bonds](#) (1997, 2005)
- [Secondary Market Securitization of Tax-Exempt Obligations](#) (1993, 1996, 2005)
- [Use of Debt-Related Derivatives Products and the Development of a Derivatives Policy](#) (1995, 2003, 2005)
 - [Derivatives Checklist](#)
- [Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites](#) (2005, updated 2006)
- [Tax Increment Financing as a Fiscal Tool](#) (2006)
- [Debt Service Payment Settlement Procedures](#) (2003, 2007)
- [Investment of Bond Proceeds](#) (1996 and 2007)
- [Need for Considerable Caution in Regard to OPEB Bonds](#) (2007)
- [Selecting and Managing the Method of Sale of State and Local Government Bonds](#) (1994 and 2007)
- [Selecting Bond Counsel](#) (1998 and 2008)
- [Public-Private Partnerships for Economic Development](#) (2008)
- [Selecting Financial Advisors](#) (2008)
- [Selecting Underwriters for Negotiated Bond Sales](#) (2008)
- [Business Preparedness and Continuity Guidelines](#) (2005, 2008)
- [Role of the Finance Officer in Privatization](#) (2009) new
- [Pricing Bonds in a Negotiated Sale](#) (1996, 2000, 2009) revised
- [Web Site Presentation of Official Financial Documents](#) (2009) new

3. GFOA Publications

- *An Elected Official's Guide to Debt Issuance*
- *An Elected Official's Guide to Tax Increment Financing*
- *Financing the Future: Long-Term Financial Planning for Local Governments*
- *Competitive v. Negotiated: How to Choose the Method of Sale for Tax-Exempt Bonds*
- *Making Good Disclosure: The Role and Responsibilities of State and Local Officials Under the Federal Securities Laws*
- *Purchasing Credit Enhancement: How to Decide if Bond Insurance Makes Sense*
- *Structuring and Sizing the Bond Issue: How to Develop an Optimal Financing Approach*

- *Tax Exempt Financing: A Primer* (Revised Edition)
- *Benchmarking and Measuring Debt Capacity* (Volume 1 of the GFOA Budgeting Series)
- *Best Practices in Public Budgeting* (www.gfoa.org/services/nacslb/)

OTHER RESOURCES

4. California Debt and Investment Advisory Commission (www.treasurer.ca.gov/cdiac/)
5. Rating Agencies:
 - a. Fitch Ratings (www.fitchratings.com)
 - b. Moodys (www.moodys.com)
 - c. Standard & Poors (www2.standardandpoors.com)
6. Municipal Securities Rulemaking Board (www.msrb.org)
 - Electronic Municipal Market Access (<http://emma.msrb.org/>)
7. Securities Industry and Financial Markets Association (www.sifma.org)
 - Investing in Bonds (<http://investinginbonds.com/>)