

POLICY 6.085

5-G I recommend the Board approve the proposed new Policy 6.085, entitled "Debt Management."

[Contact: Leanne Evans, 434-8142]

Development

CONSENT ITEM

- The draft of this proposed new Policy was prepared with the guidance of the District's outside financial advisor in conjunction with the District Treasurer and Chief Operating Officer. It was reviewed and approved by the Finance Committee in December, 2003.
- The purpose is to formalize guidelines for the issuance and management of debt, including short-term and long-term obligations issued by the School District and associated financing entities, such as criteria for evaluating and establishing the basis for comparing actual performance results achieved by debt management; facilitating the sound and efficient management of District debt; and providing guidelines for the overall debt management process so that all liabilities are managed in accordance with stated objectives.
- Attached to the back of this packet is a draft of guidelines to guide the Finance committee's recommendations to the District. Although referenced in the Policy, the guidelines are not part of the Policy itself.

43
44 5. Permissible Debt.-- The Board recognizes that debt is an integral part of the
45 District's ongoing financial management program; and both short-term and long-
46 term debt help the District accomplish its core goals. The Board also recognizes
47 that annual operating and capital revenues are cyclical, which often necessitate the
48 use of short-term financings, while the useful life of new and renovated facilities is
49 often thirty to forty years. As a result, prudent financial management will employ
50 short-term and long-term financing tools to facilitate matching assets and liabilities.

51
52 a. Short-Term Debt

53
54 i. In accordance with applicable laws such as Fla. Stat. § 1011.12(2) and §§
55 1011.13 and 1011.14, the District may issue obligations with a maturity of
56 not more than one year ("Notes") to fund anticipated short-term cash flow
57 needs due to the timing of the receipts of the annual current year ad
58 valorem tax collections from the county tax collector and other revenues.
59 The principal of the Notes and the interest thereon will be payable from,
60 and secured by, a pledge of such ad valorem taxes and other revenues,
61 as may be appropriate.

62
63 ii. Except for any issuance of taxable obligations, the District will comply
64 with the requirements of the Internal Revenue Code, prior to and
65 subsequent to the issuance of the Notes, for spending the proceeds in a
66 manner consistent with the exceptions for interest on the Notes not being
67 included in gross income for federal income tax purposes.

68
69 b. Long-Term Debt

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71 i. In accordance with applicable laws such as Florida Statutes Chapters
72 1010, 1011, and 1013 Part IV, the District will not issue long-term debt
73 obligations or use long-term debt proceeds to finance current operations
74 (except when using excess proceeds to make debt service/lease
75 payments as provided for in the financing documents). For purposes of
76 this Policy, long-term debt includes bonds, leases, certificates of
77 participation, and other similar obligations.

78
79 ii. The District may utilize long-term debt for the acquisition, construction or
80 renovation of facilities or, consistent with Florida law, for the acquisition of
81 equipment that cannot be funded from current revenue sources or in such
82 cases where it is more equitable to finance the facility or equipment over
83 its useful life. The District may also issue long-term debt to refund all or a
84 portion of its outstanding debt subject to limitations detailed in this Policy.

85
86 iii. When debt is used to finance capital improvements, the financing term

87 will be for a period not to exceed the useful life of the facilities or
88 equipment, but never greater than 30 years.

89
90 **6. Measures of Debt Levels and Debt Issuance Limits**

91
92 a. **Short Term Debt.--** The District will not exceed the maximum allowable
93 issuance size, if any, as determined by regulations governing the federal
94 taxability of the interest earned by holders of such debt.

95
96 b. **Long Term Debt**

97
98 i. **General Obligation Bonds.--** Pursuant to State Board of Education rule
99 6A-1.037(2), the measure shall be the outstanding debt-to-taxable
100 property ratio, such that a bond issue, together with other school bonds
101 outstanding against the District shall not exceed ten percent (10%) of the
102 nonexempt assessed valuation of the District.

103
104 ii. **Certificates of Participation**

105
106 A. The measure shall be lease payments as a percentage of capital
107 outlay millage dollars and shall not exceed 50% of the authorized
108 capital outlay millage, unless approved by a supermajority of the
109 School Board.

110
111 B. Additionally, the District will comply with all applicable Florida
112 statutory requirements and State Board of Education rules, and take
113 into account other factors suggested or required by the credit rating
114 agencies and/or bond insurers when preparing its capital budget and
115 each specific plan of finance.

116
117 **7. Selecting Debt Sale Methods**

118
119 a. **Short-term Debt.--** Short-term debt shall be issued through a competitive bid
120 process, except in instances where a private placement or a negotiated sale is
121 more cost effective because of unique market conditions or other extraordinary
122 factors.

123
124 b. **Long-term Debt .--** The District, with the advice and counsel of the Finance
125 Committee and the Financial Advisor, will determine whether the sale of long-
126 term debt shall be sold via competitive sale or negotiated sale after
127 considering such factors as the size, complexity of the offering, market
128 conditions, and timing of the transaction. Except where sold by negotiated
129 sale through underwriters pursuant to Fla. Stat. § 218.385, bonds must be sold

to the highest and best bidder at a public sale except as otherwise allowed by Fla. Stat. § 1010.47(2).

8. **Financing Structure**--The financing structure—consisting of matters such as principal amortization, call provisions, coupons/yields, credit enhancement, and use of hedging products—will be developed for each financing after considering relevant market conditions and then-current practices. Each structure will be developed to provide the lowest long-term effective financing cost while providing the greatest flexibility to extract additional value as market conditions change over time (such as refund debt or terminate swaps).
9. **Amortization Structure**-- Principal should be structured to provide level debt-service payments for the life of the transaction. “Wrapped debt service” and “bullet maturities” may be appropriate for certain financings, but should only be employed when necessary.
10. **Issuing Variable Rate Debt**-- The District may issue variable rate obligations in amounts, and in proportion to its fixed-rate debt, that the District, with the advice and counsel of the Finance Committee and the Financial Advisor, determines to be appropriate to achieve the District’s goals.
11. **Credit Ratings**-- Because the credit review process incorporates both quantitative analysis (fund balance, debt levels, and wealth levels) and qualitative factors (management experience, political climate, and policies/procedures), the District recognizes that credit ratings provide an indication of both the short-term and long-term financial health of the District and that higher credit ratings also result in reduced borrowing costs and decreased cost of bond insurance. Accordingly, the District will exercise prudence and diligence in preparing its budget and managing its finances to maintain its current ratings and obtain rating upgrades that reflect the District’s commitment to excellence. At the time of this Policy’s development, the District’s current ratings were:

	<u>Moody's (09/03)</u>	<u>S&P (09/03)</u>	<u>Fitch (05/03)</u>
<u>General Obligation Bonds</u>	<u>Aa3</u>	<u>AA</u>	<u>AA-</u>
<u>Certificates of Participation</u>	<u>A1</u>	<u>AA-</u>	<u>A+</u>
<u>Short-term Notes</u>	<u>MIG-1</u>	<u>SP-1+</u>	<u>=</u>

12. **Credit Enhancements**-- Credit enhancements (such as insurance and letters of credit) will be used only in those instances where the anticipated present value savings in terms of reduced interest expense exceeds the cost of the credit enhancement.
13. **Investing Debt Proceeds**-- Because safety of capital is regarded as the highest priority in handling of investment of debt proceeds, and all other investment

170 objectives are secondary to the safety of capital, the District staff, in consultation
171 with the Finance Committee and Investment Advisor, will follow investment
172 strategies that are consistent with the written Investment Policy (Policy 6.08) and
173 Fla. Stat. § 218.415 and provide the maximum return while complying with the
174 requirements of the IRS Code.

175
176 a. The District, with the guidance of the Finance Committee, Financial Advisor,
177 and Investment Advisor, will attempt to structure investments that allow the
178 District to meet exceptions to the rebate requirements in section 148(f) of the
179 Code.

180
181 b. Debt proceeds are only to be invested in permitted investments, as defined in
182 financing agreements, escrow agreements, resolutions, law, and the School
183 Board's Investment Policy (P-6.08). Neither the District nor any person under
184 its control or direction will make any investment of bond proceeds in any
185 manner that would cause the bonds to be deemed private activity bonds or
186 arbitrage bonds by the IRS under sections 141 or 148 of the Code. The District
187 will comply with all federal tax arbitrage regulations.

188
189 14. Debt Refundings.-- The District will monitor outstanding debt in relation to
190 existing conditions in the debt market and may refund any outstanding debt when
191 sufficient cost savings can be realized. Outstanding debt may be refunded as long
192 as the net present value savings is equal to or greater than 3% of the refunded
193 obligation's par amount, but this general criterion will be adjusted as outlined in the
194 Guidelines.

195
196 15. Interest Rate Hedge Contracts.-- The Board recognizes that interest rate swaps,
197 caps, collars and other hedging products (collectively referred to herein as
198 "hedges") can be an effective tool to reduce financing costs, diversify certain risks
199 and take advantage of unique market conditions.

200
201 a. Appropriate Use.-- Hedges shall not be used for speculative purposes; and
202 they may be used only when the District has received an opinion acceptable to
203 the market from a nationally recognized bond counsel firm that the agreement
204 relating to the hedge is a legal, valid and binding obligation of the District and
205 entering into the transaction complies with applicable State and Federal laws.
206 The following list includes many of the conditions under which entering into a
207 hedge may be appropriate:

208
209 i. to achieve savings as compared to a traditional debt structure available in
210 the bond market (both fixed and variable rate obligations);

211
212 ii. to achieve diversification of a particular debt offering;
213

214 iii. to reduce net interest expense within prudent risk guidelines;

215
216 iv. to prudently hedge risk in the context of a particular financing or the
217 overall asset/liability management of the District (i.e. buying interest rate
218 caps and entering into delayed start swaps);

219
220 v. to incur variable rate exposure within prudent guidelines; or

221
222 vi. to achieve more flexibility in meeting overall financial objectives than can
223 be achieved in conventional markets (i.e., a swaption with an upfront
224 payment).

225
226 b. In evaluating a particular transaction involving the use of hedges, the District
227 shall review long-term implications including costs of borrowing, historical
228 interest rate trends, variable rate capacity, credit enhancement capacity,
229 opportunities to refund related debt obligations and other similar
230 considerations.

231
232 c. **Form and Content of Hedges.--** Hedges should be in the form set forth by
233 the International Swaps and Derivatives Association (ISDA) Master Agreement
234 and the typical schedules. In preparing the agreement, the District should
235 clearly delineate termination provisions, events of default and posting of
236 collateral.

237
238 d. **Method of Soliciting and Procuring Hedges.--** The District, with the
239 guidance of the Finance Committee and Financial Advisor, will determine
240 whether the hedge shall be sold/purchased competitively or via negotiation
241 after considering such factors as the size and complexity of the offering and
242 market conditions.

243
244 i. Unless the District procures a specific team of swap counterparties in the
245 future, the District will use counterparties from its existing underwriting
246 team (or their structured products affiliates) that meet the credit criteria
247 included herein.

248
249 ii. Regardless of the method of procurement, the District shall obtain an
250 independent finding that the terms and conditions of any hedge entered
251 into reflect a fair market value of such hedge as of the date of its
252 execution.

253
254 e. **Aspects of Risk Exposure Associated with Hedge Contracts.--** The
255 District shall evaluate all of the risks inherent in a hedge transaction before
256 proceeding. The risks to be evaluated should include counterparty risk,
257 termination risk, rollover risk, basis risk, tax event risk and amortization risk.

258 The District shall endeavor to diversify its exposure to counterparties within
259 prudent limits.

- 260
261 f. **Qualifications of Counterparties.--** A counterparty must have demonstrated
262 experience in successfully executing hedge transactions. A counterparty shall
263 have a credit rating equal to or higher than the District's and credit ratings from
264 at least one nationally recognized statistical rating agency that is within the two
265 highest rating categories ("AAA" or "AA"), and ratings which are obtained from
266 any other nationally recognized statistical rating agencies shall also be within
267 the three highest investment grade categories ("A" or better), or the payment
268 obligations of the counterparty shall be collateralized or unconditionally
269 guaranteed by an entity with such credit ratings.

270
271 16. **Compliance and Reporting**

- 272
273 a. **Disclosure Policy.--** The District will provide full and fair disclosure in
274 connection with the initial sale and distribution of its publicly-marketed debt
275 instruments and provide ongoing secondary market information, in compliance
276 with the requirements of applicable federal and state securities laws and
277 regulations, including Securities and Exchange Commission Rule 15c 2-12.
278
279 b. **Budget Debt Service Payments.--** Annually the Superintendent will include in
280 the proposed budget presented to the School Board for its consideration and
281 approval the appropriations necessary to make the required debt service and
282 lease payments during the fiscal year.
283
284 c. **Compliance with Financing Covenants and the Law.--** The District shall
285 comply with all covenants and requirements of financing resolutions, and
286 applicable state and federal laws authorizing and governing the issuance and
287 administration of debt obligations.
288
289 d. **Bond Yield Arbitrage Monitoring.--** The District shall contract for arbitrage
290 calculation services to monitor the earnings on its debt proceeds for each debt
291 series and determine whether a rebate is necessary.
292
293 e. **Annual Report on Outstanding Debt.--** No later than December 31st of each
294 year, an annual report shall be submitted to the School Board, covering the
295 previous fiscal year, that will include a summary of outstanding obligations and
296 any associated hedges. At a minimum, the report will include the information
297 included in Exhibit A of the Guidelines, as may be amended from time to time
298 by the District with the guidance of the Finance Committee.
299

300 f. Database.-- In addition to the annual report, the Treasurer will maintain a
301 database of existing debt/hedge obligations. The database will include at least
302 the following information related the District's debt:
303

304 i. For all debt obligations:
305

- 306 • Debt service schedule including principal, interest, and coupon
- 307 • Issue date
- 308 • Interest rate mode (variable/fixed)
- 309 • Call provisions
- 310 • Credit enhancement
- 311 • Purpose (new money/refunding)
- 312 • Senior managing underwriter

313 ii. For all hedge obligations:
314

- 315 • Counterparty
- 316 • Type of swap (fixed receiver, fixed payer, basis, etc.)
- 317 • Key terms of the agreements, including notional amounts, interest
- 318 rates and maturity
- 319 • The marked to market value as of the most recent fiscal year end
- 320 • Credit ratings of counterparty and any applicable guarantor
- 321 • Imbedded options
- 322 • Discussion of market/structural risks

324
325 STATUTORY AUTHORITY: §§ 1001.41(2); 1001.43(2), Fla. Stat.

326 LAWS IMPLEMENTED: §§ 218.385; 218.415; 1001.41(1);

327 1001.42(10)(e), (f); 1010.47(2); 1011.12

328 - 1011.16, Fla. Stat.

329 HISTORY: New: ____ / ____ /04

Legal Signoff:

The Legal Department has reviewed proposed Policy 6.085 and finds it legally sufficient for development by the Board.

Attorney

Date

Debt Management Guidelines

School District of Palm Beach County

March 1, 2004

1. Purpose: These Guidelines are intended to add clarity to certain debt management goals, objectives, and methods stated in Policy 6.085, "Debt Management," taking into account sound fiscal management, the District's capital needs, and evolution of the financial markets.

These Guidelines are being applied to financial products that change constantly. The Guidelines should be adjusted frequently by the District, with guidance from the Finance Committee, to reflect evolution of financial products in order to maintain a sound, prudent and cost effective debt program.

2. Method of Sale

a. In conjunction with Policy 6.085(7), the following table outlines the issues to be considered when determining the appropriate method of sale.

	<u>Competitive Sale</u>	<u>Negotiated Sale</u>
Issuer		
Type of Organization	Broad-based, general-purpose government	Special-purpose, independent authority
Frequency of Issue	Regular borrower in public market	New or infrequent issuer of debt
Market Awareness	Active secondary market with wide investor base	Little or no institutional base, but growing dealer interest
Credit Quality		
Rating	"A" or better	Below "A"
Pledged Revenues	General obligation	Project supported revenues
Security Structure	Conventional resolution and cash flow; rate covenant and coverage	Unusual or weak covenants; subordinate debt
Trend	Stable	Improving or under stress
Market Conditions		
Interest Rates	Stable, predictable market	Volatile or declining market
Demand	Strong investor demand, good liquidity, light forward calendar	Oversold market, heavy supply
Debt Structure		
Tax Status	Tax-exempt, no concerns	Taxable
Debt Instrument	Traditional serial and term, full-coupon bonds	Aggressive use of innovative bond structuring, derivative products, swaps or variable rate debt instruments
Marketing		
Use of Underwriters	Broad market participation banker and direct business to local or regional firm	Ability to select "best qualified"
Investors	Process blind to ultimate investors	Sale can be managed to achieve wide distribution or targeted allotments
Pre-Marketing	Limited needs for pre-marketing	Specific pre-sale activity to generate demand
Flexibility in Timing	Limited flexibility	Greatest flexibility in timing
Fine Tuning Structure	Limited options given to bidders	Unlimited ability to fine tune
Cost		
Gross Spread	Historically, spreads have been lower	Recent data shows comparable spreads

Interest Rates	Highest market price for commodity offered on day of sale	Best match of product with specific investor demand
Preparation		
Resolution/Structure	Issuer determines own preference for managing	Professional banking support and more direct marketing input in balancing security for investors vs. flexibility for issuer
Disclosure	Issuer relies on own program disclosure	Underwriter's counsel assists in the preparation of Official Statement

b. Certificates of Participation (COPs) have become the primary vehicle for financing educational facilities in Florida. While COPs are common in Florida, they are still sold via negotiated sale due to the unique structure associated with each specific financing.

3. Debt Structure

a. Principal Amortization

Amortization of principal resulting in level debt service is preferred since this structure matches useful life of the asset with the financing. Accelerated structures and wrap around structures may be appropriate at certain times over the course of a 20 to 30 year capital financing cycle in order to facilitate the total plan. However, both accelerating and deferring principal can impact long-term capital plans negatively and should be used sparingly.

b. Interest Rate Mode

Fixed rate obligations are most common for municipal issuers. Tax-exemption results in relatively low interest rates when compared to corporate debt. Debt service for fixed rate obligations is defined resulting less risk when preparing budgets. At the same time, variable rate obligations have historically resulted in significantly lower interest rates. Large issuers with substantial debt and assets can take advantage of the expected lower cost of variable rate obligations with limited risk to net cash flow by issuing the proper amount of variable rate obligations.

The following guidelines are set after consultation with rating agencies and insurance companies.

- Variable rate thresholds – (1) No more than 50% of the District’s obligations may be issued in a variable rate mode. (2) At any given point in time, no more than 25% of the District’s outstanding debt will be unhedged variable rate obligations. Variable rate obligations that have been hedged by a variable to fixed rate swap for a period greater than the lesser of (i) five years or (ii) 75% of the remaining life of the obligation will not be considered variable rate obligations for this section (2).
- Budgeting debt service – The District will use the following procedures for budgeting debt service payments:
 - 1) Fixed rate debt – the actual debt service
 - 2) Variable rate obligations that have been swapped to a fixed rate
 - Bond rate swap – actual swap rate
 - Tax exempt index swap – swap rate plus 0.25% of the principal amount of the swapped debt

- Taxable index swap - swap rate plus 0.75% of the principal amount of the swapped debt
- 3) Variable rate obligations (actual variable rate or swapped to variable rate): the greater of:
- Twelve month average plus 0.50%
 - Most recent rate plus 0.50%

4. Refunding/Restructuring Savings Criteria

The Debt Management Policy provides for a 3% net present value savings threshold, with the cashflows discounted using the yield as defined in the Code. This general criterion will be adjusted on a case-by-case basis after considering option value, opportunity cost, rating agency/insurer criteria and risks associated with the proposed refunding transaction. For example, a materially higher savings threshold will generally be required for refunding transactions incorporating hedges and forward structures. Conversely, certain refundings (generally refundings with a very short duration) may be recommended that possess a lower savings threshold. The District may also refund existing debt for the purpose of revising legal covenants to meet particular organizational and/or strategic needs of the District. District staff and the Financial Advisor will make savings threshold recommendations for each transaction after evaluating market and risk factors.

5. Interest Rate Hedge Contracts

a. Procurement

The use of hedging products by Florida school districts is still in its infancy. Credit complications generally dictate that hedge contracts be negotiated. As this market becomes more mature, straightforward hedging transactions can be procured via a competitive process. In situations where the hedge is procured through a competitive process and the District desires to reward a particular firm for offering creative advice or wishes to achieve diversification of counterparty exposure, the District may allow a certain firm to be awarded up to a specified percentage of the notional amount of the hedge as long as the terms and conditions are equivalent to those of the winning bidder. The parameters for the bid and any provisions related to matching a bid must be disclosed in writing to all potential bidders prior to the bidding process.

The District may procure hedges by negotiated methods in the following situations:

- Due to size or complexity of a particular swap, a negotiated transaction would result in the most favorable pricing.
- A hedge is embedded within a proposed bond issue.
- Market entry/timing constraints suggest a negotiated sale.
- A negotiated transaction will promote the District's interests by encouraging and rewarding innovation.

b. Form and Content of Hedge Contract

In preparing the agreement, the District should generally provide for:

- Termination of the agreement at the market value of the agreement at any time. Generally, the counterparty shall **not** have the right to optionally terminate an agreement.
- Events of default of counterparty shall include:
 1. Failure to make payments when due
 2. Breach of representations and warranties
 3. Illegality
 4. Failure to comply with downgrade provisions
 5. Failure to comply with any other provisions of the agreement after a specified notice period.
- Posting of collateral by the counterparty or insurance

c. Counterparty exposure

No more than the greater of (1) \$50,000,000 or (2) 35% of the total principal amount of obligations outstanding can be hedged by a single counterparty (treating each separately capitalized entity with a separate rating as a single counterparty).

6. Reporting

In accordance with Policy 6.085(16)(e), the annual report submitted to the School Board, covering the previous fiscal year, will include a summary of outstanding obligations and any associated hedges. At a minimum, the report will include the information included in Exhibit A of these Guidelines, as may be amended from time to time by the District with the guidance of the Finance Committee.

