a guide for preparing a debt policy

BY PATRICIA TIGUE

GOVERNMENT FINANCE OFFICERS ASSOCIATION
A Guide for Preparing a Debt Policy

By Patricia Tigue
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Foreword

A key to good financial management in state and local governments is development and adherence to a set of financial policies. A government's financial policies provide a road map to help guide difficult decisions and promote achievement of agreed-upon financial objectives. One of the most important financial policies for governments that participate in the capital markets is a debt policy. A debt policy provides the foundation for a well-managed debt program, helping to ensure that debt is issued prudently and is affordable.

This publication offers advice on how to develop a debt policy. It stems from work undertaken by the Subcommittee on Recommended Practices of the GFOA's Committee on Governmental Debt and Fiscal Policy in developing a recommended practice on this topic. The subcommittee urged that additional guidance on this topic be provided to assist governments in formulating their own debt policies.

A Guide for Preparing a Debt Policy is the fourth volume in the Government Finance Officers Association's (GFOA) "Documents on Disk" series. The diskette that accompanies this book contains eight sample debt policies prepared by a cross section of local governments.

The GFOA wishes to thank Patricia Tigue, Senior Debt Analyst, City of Portland, Oregon, for preparing this publication. We also wish to thank Ben Hayllar, Director of Finance, City of Philadelphia, Pennsylvania; Eric Johansen, Acting Debt Manager, City of Portland, Oregon; and Peter Schaafsma, Executive Director, California Debt and Investor Advisory Commission for reviewing this publication.
Finally, we appreciate the willingness of the following jurisdictions to permit their debt policies to be used in this publication: Clark County, Nevada; City of Fort Worth, Texas; City of Fremont, California; City of Grand Prairie, Texas; Howard County, Maryland; Lehigh County Authority, Pennsylvania; City of Portland, Oregon; and City of Seattle, Washington.

Jeffrey L. Esser
Executive Director
Government Finance Officers Association
Introduction

At the core of a well-managed debt program is a government's debt policy. A debt policy establishes the parameters for issuing and managing debt. Among the important functions of a debt policy are to:

- Provide guidance to community leaders so as not to exceed acceptable levels of indebtedness and risk;
- Direct staff on objectives to be achieved, both before bonds are sold and for the ongoing management of the debt program;
- Facilitate the debt issuance process by making important decisions ahead of time; and
- Promote objectivity in decision making and limit the role of political influence.

A consistently applied debt policy provides evidence to the rating agencies of a community's commitment to sound financial management and controlled borrowing practices. As such, it is regarded positively in evaluating jurisdictions' creditworthiness.

This publication is designed to assist governmental issuers in developing a debt policy. It provides an overview on why a debt policy is so important for governmental issuers, and examines elements that governments may want to include in their debt policies. Sample debt policies from various jurisdictions have been selected for inclusion on a diskette that accompanies this booklet. These samples are accessible in WordPerfect 6.1 and ASCII text formats. Samples have been chosen to illustrate the range of issues that may be addressed in a debt policy.
Debt policies, like all financial policies, should reflect community needs and issuer goals. A good debt policy has a number of characteristics, including the following:

Promotes attainment of financial, planning and management objectives

A debt policy should encourage a government to consider how the issuance of debt fits with other long-term planning, financial and management objectives. A debt policy that is well-integrated with other objectives and strategies of a government helps promote consistency in decision making and is more likely to lead to achievement of broader government goals.

For many governments, the desire to meet program and service needs is often in conflict with goals for fiscal stability. Needs often exceed the government’s ability to pay for them. The policy development process forces a government to evaluate these competing goals and make choices regarding the amount of debt that will be issued in support of programs and services. The process should serve to illuminate tradeoffs so that decision makers and others affected by the policy understand the limitations imposed by the policy and the effect on available funding.

Because most governments rely on some debt to pay for capital
improvements, it is essential that debt policies be consistent with capital program policies. Explicit consideration should be given to the magnitude of capital needs and the mix of debt and pay-as-you-go funding needed to support the capital program. Limitations on permissible debt affect the size of the capital program that can be financed. Restrictions on projects that qualify for debt financing increase pay-as-you-go funding requirements which must be balanced with debt service and operating expenditures. In developing capital and debt policies, governments must strike a balance between making sure capital needs are met and keeping the amount of debt issued to support the capital program at affordable levels.

A debt policy also should promote achievement of managerial objectives. Provisions in the policy such as the types of debt that may be issued or permitted methods of sale should reflect the size of a government’s debt program, frequency of issue, experience of staff and number of staff available to manage the program.

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**Takes a comprehensive approach to affordability**

In establishing debt policy objectives, a government will want to undertake a comprehensive review of factors affecting its ability to issue debt. A policy on affordable levels of debt will be based on a government’s financial condition, including trends in financial performance, service levels, the tax and revenue base, and the impact of debt on its financial outlook. Within the government, it is important to take account of all debt issued, including general obligation, enterprise, lease and moral obligation debt. The analysis also should incorporate the needs and debt commitments of other governmental entities relying on the same tax base, and how planned debt issuance will affect overall debt burden on the community.

Additionally, consideration should be given to financial management objectives. If debt service payments become an increasing percentage of total operating revenues, a government will have less flexibility in addressing new or emerging service needs.
Financial managers must feel comfortable that debt service payments can be met without jeopardizing the government's ability to accommodate unexpected changes in its financial position. Within overall affordability targets, the policy may also address annual amounts that will be authorized to avoid unmanageable swings in debt service levels. It is important to evaluate the impact of proposed affordability targets on the ability to fund capital program requirements. Capital program policies may need to be adjusted to reflect the constraints imposed by the debt policy.

Reflects community attitudes and government philosophy

Debt policies should reflect how much debt is acceptable to the community. In part, this will be guided by the extent of capital needs and the financial condition of the government and the community. Consideration also should be given to factors such as prevailing attitudes on taxes and rates and the general philosophy of the community and its leaders on borrowing. Another factor to evaluate is the government's attitude toward risk. Governments that are risk averse may want to limit the ability to use debt instruments that expose them to greater interest rate fluctuation, such as variable rate or derivative instruments, or may want to establish conditions on how these instruments may be used. The process of developing a debt policy should serve to uncover these less quantifiable issues.

Sets limits but preserves flexibility

It is important to develop a debt policy that provides concrete guidance in the many areas in which a governmental issuer will need to make decisions. Nevertheless, the policy should be
sufficiently flexible to permit the government to take advantage of market opportunities or to respond to changing conditions. A policy on advance refundings might set a target of a five percent net present value savings; however, if interest rates are at historic lows and expected to rise, a lower threshold might be justified so as not to miss an opportunity for savings. Policies should identify when exceptions are permitted and procedures for deviating from a policy.

Is formally adopted and periodically reviewed

Debt policies should be formally submitted to and adopted by a jurisdiction’s elected officials. Once adopted, the policy should be compiled with other policies and disseminated to the public through budget and planning documents or other materials published by the government, as appropriate.

It is important to monitor and report periodically on adherence to the policy. Compliance with outstanding debt or debt service limitations and other measures of affordability should be documented in the budget document, annual report or other reports, as appropriate. The debt policy itself should be reviewed from time to time to ensure that it remains consistent with financial and management objectives.
Section 2
Elements of a Debt Policy

This section describes components of a debt policy. Before deciding on elements to include, some initial thought should be given to the scope of the policy. One point to consider is what obligations of the government are to be regarded as “debt,” and thus covered by the debt policy. Another point is the size and complexity of the debt program and the ability of the staff to manage it. Clearly, a debt policy prepared by a small issuer of primarily general obligation debt is not expected to incorporate the same range of items as a policy of a larger issuer with more varied types of financings. The scope of the policy and areas covered must be relevant for decisions that will be made.

When developing a debt policy, it is important to remember that many parties are affected. These include elected officials; individuals charged with managing the debt program; staff responsible for preparing the budget, the capital program and land use or other long-term plans; other governments; and business and citizen groups. Therefore, the process of developing the policy should strive to involve these groups, as appropriate. An open process helps promote understanding of significant issues affecting the government and helps achieve buy-in to the policy.

The remainder of this section addresses elements of a debt policy. The GFOA has recommended practices in many of these areas that may be helpful to issuers in developing policies, including analyzing debt capacity, using various types of debt instruments (e.g., variable rate debt), selecting external finance professionals, and choosing the method of sale. Many of the recommendations are highlighted in this section. Governments
may want to review the set of GFOA recommended practices periodically to determine if new ones have been added or existing ones have been updated when reviewing their debt policy.

Purposes

Debt policies will typically describe purposes for which debt may be issued. These purposes may be broadly stated, such as permitting debt to be issued for capital improvements or for operating purposes. A government may want to provide more guidance on the issuance of debt for either of these purposes. The policy may place restrictions on the types of capital projects that may be funded with debt (e.g., projects with a useful life of more than five years or a certain cost). Some governments explicitly prohibit financing the purchase of equipment such as vehicles or computer equipment with debt.

Restrictions also may be placed on a government’s ability to fund operating deficits with debt. Debt issued for operating purposes may be limited to cases where there is reasonable certainty that a known source of revenue will be received in the current budget period to repay the debt or where there is a clear financial emergency that was not anticipated. The debt policy may also provide guidance on the maturity of the debt and whether it may be rolled over into a subsequent fiscal year.

Limitations on indebtedness

The amount that may be issued is an essential component of a debt policy. This provision must be guided by legal or statutory limitations, but should also be based on an analysis of debt affordability. As noted earlier, debt limitations may reflect the government’s philosophy on the amount of debt it wants to incur.

Debt affordability is determined by a number of factors related to the government’s financial condition, economic and demographic trends in the community, and outstanding debt levels. It also will be affected by the outstanding and planned debt
of other governments in a community relying on the same tax base. Exhibit 1, taken from the GFOA recommended practice entitled *Analyzing Debt Capacity and Establishing Debt Limits*, summarizes some of the key points that should be evaluated in assessing debt capacity.

Unfortunately, there is no magic formula that can be applied to determine an "affordable" level of debt. Good judgment is essential in establishing these targets. One approach used by some governments to help evaluate affordability is through the use of benchmarks. Key debt ratios are compared with those of other governments of similar size, operations, and community characteristics.\(^1\) Some governments also compare themselves against ratios developed by rating agencies, such as Moody’s *Medians*.

Overlapping or underlying debt levels are integral to an affordability assessment. Issuers in several communities have taken a coordinated approach to debt issuance to keep overall debt at acceptable levels. One of the pioneering efforts to develop a joint issuance strategy was made by governments in the St. Paul, Minnesota metropolitan area. Representatives of the City of St. Paul, St. Paul Public Schools, Ramsey County and the St. Paul Port Authority have formed an ad hoc advisory committee consisting of elected officials and staff that collaborates on capital investment strategies and debt issuance plans. Among the objectives identified by the committee in a November 1996 report are to:

- Maintain overlapping general obligation debt ratios within a range approved by the four jurisdictions for the five-year period of 1996-2000;
- Be responsible for notification to other jurisdictions when unanticipated capital needs require that the jurisdictions confer on recommendations for rescheduling of debt issuance plans to keep within the adopted target ranges;

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Exhibit 1
FACTORS TO CONSIDER IN EVALUATING DEBT CAPACITY

• Statutory or constitutional limitations affecting the amount that can be issued, such as
  -legally authorized debt limits and
  -tax or expenditure ceilings;

• Other legal limitations, such as coverage requirements or additional bonds tests imposed by bond covenants;

• Measures of the tax and revenue base, such as
  -projections of key, relevant economic variables (e.g., assessed property values, employment base, unemployment rates, income levels and retail sales),
  -population trends,
  -utilization trends for services underlying revenues and
  -factors affecting tax collections, including types of property, goods or services taxed, assessment practices and collection rates;

• Evaluation of trends relating to the government’s financial performance, such as
  -revenues and expenditures
  -net revenues available after meeting operating requirements,
  -reliability of revenues expected to pay debt service and
  -unreserved fund balance levels;

• Debt service obligations, such as
  -existing debt service requirements and
  -debt service as a percentage of expenditures, or tax or system revenues;

• Measures of debt burden on the community, such as
  -debt per capita,
  -debt as a percentage of personal income,
  -debt as a percentage of full or equalized assessed property value and
  -overlapping or underlying debt; and

• Tax-exempt market factors affecting interest costs, such as
  -interest rates,
  -market receptivity and
  -credit rating.
• Identify annually the immediate debt-related conditions of the four jurisdictions that would impact St. Paul residents, and take appropriate action to remain consistently within the debt level ranges approved by the four jurisdictions;

• Identify annually intermediate- to long-range capital spending and debt conditions that would impact St. Paul residents' property taxes, and fit proposed spending to the group's debt management goals; and

• Exchange information and expertise during each jurisdiction's capital improvement budgeting process, such that the jurisdictions can eliminate duplication, share facilities where appropriate and provide the taxpayers with the 'greatest return for the jurisdictions' capital improvements.'

While such an approach takes time, it can have significant benefits in making sure all jurisdictions in a community are aware of one another's financing needs and plans, and the impact of these plans on community debt burden.

In addition to affordability considerations, debt limits also may be guided by a government's philosophy about how capital improvements will be paid for. Some governments prefer to pay for improvements largely from available cash, including current year revenues and fund balances, and may choose to establish a debt ceiling that is below the amount that is otherwise affordable. Limiting the amount of debt has the advantage of preserving credit quality, but careful planning is needed to be sure that funding is available when needed for capital improvements. Equity considerations—that is, who benefits and who pays for the project—may also enter into a policy regarding debt limitations. For capital projects with long useful lives, using debt funding often provides a better match between those paying for the project and those benefitting from it. Debt limitations may be guided by a government's desire to achieve equity objectives in addressing capital project needs.

Debt limitations may be set either by specifying a maximum amount of outstanding debt or maximum level of debt service. In

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1Capital Investment and Debt Management for Saint Paul Local Governments, November 25, 1996, p. 3.
some cases, governments establish coverage requirements or other ratios that serve to limit the amount of outstanding debt, even if not required by a bond ordinance or indenture. Examples of such limitations are:

- The ratio of general obligation bonds to estimated market value of property will not exceed 3 percent;
- Debt per capita will not exceed $200;
- The ratio of debt service expenditures to combined general fund disbursements will not exceed 10 percent; and
- Net operating revenues must provide at least 1.25 times coverage of maximum annual debt service.

Debt limits should be developed for each type of debt a government is authorized to issue, such as general obligation, enterprise-supported debt, short-term debt, variable rate debt and lease-backed debt. It is important to periodically review these limitations and the underlying affordability analysis to make sure that there are no fundamental changes in the government's financial position or in broader community and economic trends.

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**Types of debt**

Debt policies typically include provisions on the types of debt that may be issued and criteria for using these instruments. These provisions should incorporate legal or statutory limitations. Other considerations such as staff size, experience and financial objectives also should be evaluated.

GFOA recommends that specific policies be developed regarding the issuance of:

- Short-term and long-term debt;
- General obligation and revenue debt;
- Fixed and variable rate debt;
- Lease-backed debt, including certificates of participation;
- Special obligation debt such as assessment district debt;
- Conduit issues; and
- Taxable debt.
Some governments specify the types of projects that qualify for funding using a particular type of debt or revenue source as security for the debt. For example, a debt policy may include a provision that gas tax revenues may be used for debt issued for transportation projects only.

Policies may address not only whether a government is able to issue a particular type of debt, but also any overall philosophy or specific conditions attached to the use of these instruments. Some governments have broad policies stating their preference for issuing revenue bonds backed by user fees or another dedicated revenue stream before issuing general obligation debt. Some have policies that tie the issuance of variable rate debt to asset/liability management objectives.

Governments that issue conduit bonds may want to develop specific policies and procedures that the conduit borrower must follow in order to qualify for debt financing through the issuer. Specific points that the policy may address are the following:

- **The issuer's role in selecting underwriters for conduit bonds.** The issuer may ask to approve a conduit borrower's choice of underwriter or develop a list of acceptable underwriters and allow the conduit borrower to select from among the list.

- **Minimum ratings that are acceptable for a conduit issue.** An issuer may establish guidelines on credit ratings that are acceptable for bonds to be issued through a public offering. A conduit offering that fails to meet this credit threshold would need to be credit enhanced or sold through a private placement.

- **Compliance with disclosure and rebate requirements.** An issuer may request that the conduit borrower enter into a formal agreement to provide annual financial and operating information required by Securities and Exchange Commission Rule 15c2-12 and meet arbitrage requirements.

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**Structural features**

It is common for a debt policy to address security and structural
features. When formulating policies in these areas, the following are among the questions to consider:

- What revenues may be pledged for various types of issues? To what extent is the government willing to provide support from other sources of revenue (e.g., for enterprise debt, is the government willing to use general fund revenues, if necessary, for debt service payments)?
- Is the government willing to enter into moral obligation pledges to guarantee debt for other entities?
- Should restrictions be imposed on the maturity of the debt and how rapidly debt must be retired?
- Should limitations be placed on the debt repayment schedule (e.g., level principal payments, level debt service payments)?
- Will any restrictions be placed on the government's ability to capitalize interest? May capital appreciation bonds be issued?
- Will subordinate lien debt be considered, and if so, under what circumstances may debt be issued on a subordinate basis?
- Must the bonds be sold at par or can original issue discounts or premiums be used?
- What is the government's philosophy on call provisions? For example, will optional call provisions be required and are there cases when non-callable bonds may be considered?
- Under what circumstances may bond insurance or other forms of credit enhancement be used?
- Will a reserve account for debt service be maintained, even if not required by the rating agencies or for marketability purposes?
- Can derivative products, such as interest rate swaps, inverse floaters, or interest rate caps and collars, be used?

Statutory or legal requirements and provisions in existing trust indentures should be reviewed when establishing policies on debt structure. Other factors that may affect these policies are the magnitude of the government's capital needs and ability to fund them, its objectives regarding a credit rating, and its desire for overall flexibility in managing the debt program.
Credit objectives

Many governments include objectives for a credit rating in their debt policy. Often, such provisions relate to the current rating of the government (e.g., the government will strive to maintain or improve its current "A" rating). Another way credit quality is addressed is in relation to use of credit enhancement. Some debt policies include a statement that if the rating of its direct debt falls below some threshold, then credit enhancement will be sought to improve marketability and cost-effectiveness. The policy may also address if or when unrated bonds may be issued.

A related item that is often included in a debt policy is maintenance of good relations with the rating agencies. Routinely communicating with the rating agencies and keeping them informed of significant developments that could affect the issuer's credit rating is an important part of a well-managed debt program. The debt policy may identify who is responsible for communicating with the rating agencies and reports that will be sent on an ongoing basis, such as annual financial reports or budget documents.

Method of sale

The debt policy should address the methods of sale—competitive, negotiated or private placement—that may be used. Some governments are restricted by law or statute as to the method of sale. In cases where there are no such requirements, a government may be guided by its philosophy on how services are to be procured. An issuer may require competitive sales because of its general philosophy that competitive bidding is the fairest way of offering the bonds and results in the best prices.

Other governments choose to retain flexibility in selecting the method of sale. There are reasons when negotiated sales may be preferred, such as when a unique or poor credit is being offered, market conditions are volatile or otherwise difficult, an unusual structure is being contemplated, an advance refunding is planned where projected savings are marginally above a policy threshold,
or the bonds are unrated. For this reason, debt policies may provide only general guidance on how bonds may be sold. A policy may encourage competitive sales except in circumstances where this method of sale would not result in the best outcome for the government, in the opinion of the finance director, debt manager or other designated individual. Governments will sometimes specify or make reference to procedures that must be followed when using negotiated or private placement methods of sale, such as how outside service providers will be selected, information that must be supplied as part of the pricing, and procedures for conducting and evaluating the outcome of the sale.

Method of selecting financial consultants

Governments engage the services of a variety of finance professionals in the sale of bonds, such as a bond counsel, financial advisor, senior managing underwriter and co-managers, printer, rebate consultant and disclosure counsel. A debt policy will often describe how these service providers will be selected. The policy may address selecting advisors through a request for proposals process, responsibilities for evaluating firms and awarding contracts, the permitted length of a contract and procedures for reviewing contracts, and development of selection procedures. Reference is sometimes made to general procurement codes already in place for a particular jurisdiction.

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3For a more detailed discussion on conditions favoring each method of sale, see Competitive vs. Negotiated: How to Choose the Method of Sale for Tax-Exempt Bonds, GFOA, 1994.

4GFOA’s recommended practice on Preparing RFPs to Select Financial Advisors and Underwriters, 1997, provides guidance on areas that should be addressed in developing RFPs for financial advisors and underwriters.
Refundings

Governments undertake refundings for a number of reasons, such as to achieve savings on debt service costs, restructure outstanding debt or change burdensome bond covenants. A debt policy should include provisions on when debt may be refunded. Policies may be developed for both current refundings (in which the refunded bonds are called or mature within 90 days of the issuance of the refunding bonds) and advance refundings (in which the refunded bonds are called or matured after 90 days of the issuance of the refunding bonds).

When a government undertakes a refunding, it invests significant time and incurs costs that reduce the overall level of savings. Additionally, interest rate volatility makes it difficult for issuers to choose the optimal time to undertake an advance refunding. Thus, opportunities to achieve savings at any point in time must be weighed against the possibility of future changes in interest rates that could result in either greater or lesser savings. This is particularly important for advance refundings which are limited in number by federal tax law. In order to provide guidance to decision makers and to ensure that advance refundings are cost-effective, many governments establish thresholds on minimum present value savings that must be achieved. For example, a debt policy may specify that an advance refunding for savings may only be undertaken if savings as a percentage of the refunding bonds, net of issuance costs and any cash contributions, is at least 5 percent. Other thresholds may be developed for current refundings.

A debt policy should also provide guidance on whether refundings may be undertaken to restructure debt or change bond covenants. Typically, present value savings thresholds will not apply for these types of refundings. The policy may specify conditions or procedures that must be followed when refundings are undertaken for these reasons.

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Disclosure practices and arbitrage compliance

Provisions related to disclosure and arbitrage requirements tend to be very general in most debt policies. Often, the policy will simply state that the government will comply as required by federal regulations. The policy may designate an individual who will be responsible for ensuring compliance, reports that will be prepared and frequency of reporting, including when arbitrage calculations will be performed.

Amendments to SEC rule 15c2-12 prohibit dealers from underwriting municipal securities of $1 million or more unless the governmental issuer or an obligated person has contractually committed to providing annual financial information and notices of material events. The obligated person is determined on the basis of whether the financial information of that party is relevant to investors in the bonds. For certain types of securities issued by a government, such as land-based or conduit financings, the obligated person may include entities other than the government itself. Land-based financings are particularly problematic because developers with significant interests in the project may change from the time of the initial offering. A debt policy can set forth the issuer’s policy on designation of an obligated person, including criteria to determine whether an entity qualifies as an obligated person, and issuer requirements to ensure that continuing disclosure obligations are met.

Investment of bond proceeds

Policies pertaining to the investment of bond proceeds are sometimes included in a government’s investment policy. If not, they should be covered in the debt policy. Among the provisions that may be addressed are:
• Designation of authority for investing proceeds;
• Use of investment advisors and selection procedures;
• Investment strategy (active v. passive) and objectives for investment of proceeds (safety, liquidity, yield);
• Permitted investments;
• Credit/collateralization requirements;
• Procedures for purchasing investments (e.g., competitive bidding process, procedures to ensure full disclosure of all fees and verify fairness of price); and
• Policy to ensure bond proceeds are not commingled with operating funds to facilitate arbitrage compliance.

Conclusion

This section has described elements that are commonly found in a debt policy. Among them are provisions establishing overall limitations on the issuance of debt and procedures that must be followed when debt is issued, including who is responsible for particular tasks, and the time frames in which certain actions must occur and reports must be filed. Philosophical issues regarding levels of indebtedness and who pays for debt financed projects may also be addressed.

Developing a debt policy takes time, but is integral to achieving broader policy goals of the government. A debt policy keeps debt at affordable levels and ensures that the debt program is manageable given the resources of the government. The GFOA has developed a recommended practice on developing a debt policy, shown in Exhibit 2.
Exhibit 2
GFOA RECOMMENDED PRACTICE
Development of a Debt Policy (1995)

**Background.** The foundation of any well-managed debt program is a comprehensive debt policy. A debt policy sets forth the parameters for issuing debt and managing the debt portfolio and provides guidance to decision makers. The debt policy should recognize a long-term commitment to full and timely repayment of all debt as an intrinsic requirement for entry into the capital markets. Adherence to a debt policy helps to ensure that a government maintains a sound debt position and that its credit quality is protected. A debt policy is beneficial because it enhances the quality of decisions, rationalizes the decision-making process, identifies objectives for staff to implement, demonstrates a commitment to long-term financial planning objectives, and is viewed positively by the rating agencies.

**Recommendation.** The Government Finance Officers Association (GFOA) recommends that all state and local governments intending to issue debt develop a comprehensive debt policy. The elements to be addressed in a debt policy include:

- the purposes for which debt may be issued;
- legal debt limitations or limitations established by policy, including limitations on the pledge of the issuer's general credit;
- types of debt permitted to be issued and criteria for issuance of
  - short-term and long-term debt,
  - general obligation and revenue debt,
  - fixed and variable rate debt,
  - lease-backed debt,
  - special obligation debt such as assessment district debt,
  - conduit issues, and
  - taxable debt;
- structural features that may be considered, such as
  - maturity of the debt,
  - setting the maturity of the debt equal to or less than the useful life of the project,
  - use of zero coupon bonds, capital appreciation bonds, deep discount bonds, or premium bonds,
  - debt service structure (level debt service payments, level principal payments or other repayment structure defined by state law),
Exhibit 2, continued

- redemption provisions (mandatory and optional call features),
- use of credit enhancement,
- use of senior lien and junior lien obligations, and
- use of derivative products;

• credit objectives, such as
  - maintenance of specific credit ratings, and
  - adherence to benchmark direct and overall debt ratios and other
    affordability targets;

• authorized methods of sale, such as
  - competitive sale
  - negotiated sale, and
  - private placement;

• method of selecting outside finance professionals;

• policy on refunding of debt;

• primary and secondary market disclosure practices;

• compliance with federal tax law provisions, such as arbitrage requirements;

• integration of capital planning and debt financing activities; and

• investment of bond proceeds where otherwise not covered by explicit written
  law or written investment policy.

In order to be an effective management tool, provisions of the debt policy must
be compatible with the jurisdiction's goals pertaining to the capital program and
budget, the financial plan, and the operating budget. A debt policy also should
strike an appropriate balance between establishing limits on the debt program
and providing sufficient flexibility to respond to unforeseen circumstances and
new opportunities. Finally, a debt policy should be formally adopted by the
legislative body, and the debt program should be continuously monitored to
ensure that is in compliance with the debt policy.
Debt policies from various jurisdictions were chosen to be included on the enclosed diskette for your reference and use. Please note that the Government Finance Officers Association is not endorsing any of these debt policies as models, but has provided them for your reference.

Exhibit 3 summarizes key elements of a debt policy, and where each of these elements can be found in the selected samples. Note that Par I.A means the section can be found within major heading “I,” subheading “A.” Also, I.A-C means that information is included in subheadings “A” through “C.”

These samples were designed to meet the needs of particular governments; hence, they should be used only as a starting point. A debt policy should be tailored to address the goals and concerns of a government. Care should be taken to ensure that the debt policy is consistent with other financial policies of the government.
### Exhibit 3
**MAJOR COMPONENTS OF SAMPLE DEBT POLICIES**

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*Also included is the Policies and Procedures document for the City of Fremont's Community Facilities District Financing Program.*