LAKE HAVASU CITY, ARIZONA

DEBT MANAGEMENT POLICY

DECEMBER 2009

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Introduction

The City recognizes 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 outstanding debt and provides guidance to decision makers regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, method of sale that may be used and structural features that may be incorporated. The debt policy should recognize a binding 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 credit quality is protected. Advantages of a debt policy are as follows:

- enhances the quality of decisions by imposing order and discipline, and promoting consistency and continuity in decision making,
- rationalizes the decision-making process,
- identifies objectives for staff to implement,
- demonstrates a commitment to long-term financial planning objectives, and
- is regarded positively by the rating agencies in reviewing credit quality.

Incurring long-term debt obligates current and future taxpayers. Excess reliance on long-term debt can cause debt levels to reach or exceed the government's ability to pay. Therefore, judicious use of long-term debt will provide assurance that future residents will be able to service the debt obligations left by former residents.

This policy is meant to supplement the legal framework of public debt laws provided by the Arizona Constitution, State Statutes, federal tax laws and the City's current bond resolutions and covenants. For the purposes of applying this policy, lease-purchase agreements and certificates of participation in lease-purchase agreements should be regarded as long-term debt.

The City has adopted a separate Community Facilities District (CFD) policy detailing the policy and procedures of the City related to any future consideration of the formation of a CFD and issuance of related debt.

This debt management policy has been adopted by the City Council and the Finance Director is responsible for implementation and oversight of this policy. The City Council may approve exceptions to this policy if it is in the best interest of the City.

I Conditions for Debt Issuance

1.01 Purposes and Uses of Debt

(a) The overall objective of the debt issuance and management policy of the City is to ensure that financial resources of the City are adequate to allow the City to pay its debts when due.

(b) The City will issue debt only for projects identified in the adopted CIP or capital equipment contained in the adopted budget. The City will first attempt "pay as you go" capital financing for CIP projects less than $1,000,000, and for equipment purchases less than $50,000.

(c) The City is prohibited from using tax-exempt long-term debt to fund current operations and shall not issue debt for projects that can be funded from current revenues or resources.

(d) The City will not issue general obligation (GO) debt for projects predominately supported by fees and charges unless the debt is for the purpose of constructing utility enterprise improvements.

1.02 Types of Debt

(a) Debt financing alternatives include general obligation bonds, revenue bonds, commercial paper, lease/purchase agreements (whether or not certificated), special assessment revenue bonds, and other obligations. Where practicable, the City will use special assessment, revenue, or other self-supporting debt instead of general obligation bonds.

(b) The City will consider the benefits of using state and federal supported, and therefore less expensive, loan programs such as those offered by the Greater Arizona Development Authority or the Water Infrastructure Financing Authority of Arizona to finance qualifying infrastructure before considering an open market transaction.

(c) Contractual debt, such as lease-purchase agreements and installment obligations, which are non-voter approved, will be utilized only when a dedicated revenue source (e.g., golf course revenue, privilege tax, bed tax, etc.) can be identified to pay debt service. The following considerations will apply to the question of pledging project (facility) revenues towards debt service requirements:

a. The project requires monies not available from other sources;
b. Matching fund monies from outside agencies are available which may be lost if not applied for in a timely manner;
c. Catastrophic conditions;
d. The project to be financed will generate net positive revenues (i.e., the additional revenues generated by the project will be greater than the debt

service requirements). The net revenues should not simply be positive over the life of the bonds, but must be positive each year within a reasonably short period (e.g., by the third year of debt service payments).

e. An independent feasibility study should be performed to estimate the economics of any proposed enterprise system debt obligations.

1.03 Project Life

(a) The City will utilize long-term debt to finance capital projects with long useful lives, generally ten years or more. Financing capital projects with debt provides for "intergenerational equity", as the actual users of the capital asset pay for its cost over time, rather than one group of users paying in advance for the costs of the asset.

(b) The term of the financing for CIP projects may not exceed the useful life of the asset being financed.

(c) The City may use lease/purchase financing (whether or not certificated) for capital equipment identified in the adopted budget with a useful life longer than three years.

1.04 Refundings and Restructurings

Restructurings, refinancings, and advance refundings are intended primarily to reduce the City's debt service costs, manage an enterprise rate structure, or to provide maximum future borrowing flexibility. Refundings or restructurings will be measured against one of the following objectives:

(a) the net present value debt service savings exceeds 2.5% of the debt service being refunded,(refundings only, net present value savings defined as present value savings divided by the principal amount of bonds to be refunded)
(b) the present value of the savings exceeds $750,000,
(c) modification of restrictive covenants, or
(d) modification of the existing debt structure for the benefit of the City.

II Compliance with Laws and Requirements

2.01 The City will comply with all applicable requirements of Title 9 (relating to utility financing), Title 35 (relating to general obligation bond financing) and Title 48 (relating to street and highway user revenue financing) of the Arizona Revised Statutes and other legal requirements pertaining to the issuance of bonds or debt obligations by the City or its debt issuing authorities, or the execution and delivery of certificates of participation.

2.02 The City will comply with all U.S. Internal Revenue Service arbitrage rebate requirements applicable to its tax-exempt obligations. The City will perform an initial arbitrage calculation report approximately two years after the issuance of the debt to determine any potential liability, which if any, is due on the fifth year from the closing date of the issue.

2.03 The City will comply with the provisions of Proposition 200, passed by the voters on January 14, 1997, as applicable.

III Debt Service Limitations

3.01 Before issuing debt, the City will undertake a debt capacity analysis performed by a qualified financial professional. The City's financial advisor can perform this analysis as part of the issuance process (provided the financial advisor does not also underwrite the bonds or other obligations).

3.02 Annual debt service supported by the City's General Fund will not exceed 15% of annual General Fund revenues. This includes debt directly paid from General Fund revenues, and transfers for debt service payments that Council has committed to supporting from General Fund revenues.

3.03 Total annual debt service will not exceed 25% of the City's annual operating revenue in order to control fixed costs and ensure expenditure flexibility, unless a majority of the voting electorate of the City, in a duly called election for that purpose, approves a higher amount, secured, in appropriate cases, by a property tax levy. Operating revenues are defined as all revenues of the City excluding proceeds from issuing debt, grant proceeds for capital projects and proceeds from sales of real property.

3.04 Improvement District (ID), including the Lake Havasu Irrigation and Drainage District, and Community Facility District (CFD) debt service is not included in the City's debt capacity analysis because it is paid by district property owners and is not an obligation of the general citizenry. Separate criteria have been established regarding CFD debt policies.

IV Limitations on Outstanding Debt

4.01 The Arizona Constitution limits a City's bonded debt capacity (outstanding principal) for general obligation bonds to certain percentages of the City's secondary assessed valuation by the type of project to be constructed. The City will maintain debt ratios at the time of issuance within the Arizona Constitution limits.

4.02 Principal indebtedness for projects involving water, sewer, artificial lighting, parks, open space, recreational facility improvements, public safety and emergency management facilities, and streets and transportation may not exceed 20% of the secondary assessed value of assessable real property in the City at the time of issuance.

4.03 Principal indebtedness for any other general purpose project may not exceed 6% of the secondary assessed value of assessable real property in the City at the time of issuance.

V Characteristics of Debt Structure

5.01 To the extent practicable, the City will design its overall debt repayment structure to recapture its credit capacity as rapidly as possible for future use.

5.02 As an example, for an obligation having a twenty-year term, the City will strive to repay at least 20 percent of the principal amount within five years and at least 40 percent within ten years.

5.03 Bond interest earnings will be applied to reduce debt service on the bonds or, to the extent not required for such purpose, to fund changes in the bond financed Community Investment Program, as approved by City Council.

5.04 The target "average weighted maturities" for general obligation and revenue bonds of the City having a twenty year term (except loans from the Water Infrastructure Finance Authority of Arizona or the Greater Arizona Development Authority) will be twelve and one half (12 ½) years.

5.05 To the extent economically feasible, the City will apply for underlying ratings on all long-term obligations.

5.06 The City will purchase credit enhancements for its bond issues or other long-term obligations if the present value of the debt service savings is greater than the cost of the enhancement on a present value basis.

5.07 The City will invest bond proceeds according to the City's adopted Investment Policies. Bond funds will not be commingled with operating funds.

VI Debt Issuance Process

6.01 The City will generally conduct financings on a competitive basis. However, negotiated financings may be pursued in cases of market volatility or unusual or complex financings or security structures.

6.02 The City will employ outside specialists to assist in developing a bond issuance strategy, preparing bond documents, and marketing bonds to investors. The key professionals in the city's financing transactions include its financial advisor and bond counsel, underwriter (depending on the type of financing), and city representatives. Other outside firms, such as those providing paying agent/registrar, trustee, credit enhancement, credit ratings, auditing, or printing services, are retained as required. The financing team will meet regularly to review the overall financing strategy and make recommendations to the City Manager and/or City Council, as requested.

6.03 An analysis showing the impact of any issue of long-term obligations together with outstanding indebtedness on the City's debt capacity and ratings, and conformity with City debt policies, will accompany every future long-term financing proposal.

6.04 The City will communicate, and, where appropriate, coordinate with all jurisdictions with which it shares a common tax base concerning collective plans for future debt issues.

6.05 General Obligation debt, which is supported by property taxes and changes in proportion to the City's assessed valuation and/or property tax rate increases, will be utilized as authorized by voters. Other types of voter-approved debt (e.g., water, sewer, and HURF) may also be utilized when supported by dedicated revenue sources (e.g., rates, fees and user charges). Voter approval requirements are based on state statutes and will be evaluated during the review of the financial alternatives for each project being considered by the City.

6.06 General Obligation debt issuances will be managed to match funds to Capital Improvement Program cash flow requirements while being sensitive to the property tax burden on citizens. Careful management of debt issuances will enable the City not to exceed a target tax rate of $1.00 per $100 of assessed value for long-term indebtedness.

6.07 <u>General Obligation (GO) Debt process</u>

(a) Ad valorem (property) taxes levied on assessable real property in the City are the source of funds to make annual debt service payments.

(b) To the extent practicable, the City will structure General Obligation bond issues to create level debt service payments over the life of the issue.

(c) Secondary property tax rates will be determined and taxes will be levied each year as part of the budgetary process (pursuant to State law) to pay the debt service coming due on General Obligation bonds currently outstanding or expected to be issued within the fiscal year.

(d) Interest earnings on bond fund balances will be used to pay debt service on the bonds unless otherwise committed for other uses or purposes of the project.

6.08 <u>Revenue Debt process</u>

(a) Revenue bonds are defined as bonds on which the debt service is payable from the revenue generated from the operation of the project being financed or a category of facilities, from other non-tax revenues of the City, or from other designated taxes or fees, such as highway user revenues, excise taxes, or special fees or taxes. For any debt obligations on which the debt service is paid from revenues generated by the project and/or partially paid from non-property tax sources, such bonds or obligations are deemed to be revenue bonds and are excluded from the calculation of the annual debt service limitation described in Section III of this policy.

(b) Revenue bonds of the City will be analyzed carefully by the Finance Department for fiscal soundness. The issuance of revenue bonds will be subject to the most careful review and must be secured by covenants sufficient to protect the bondholders and the City.

(c) To the maximum extent practicable, revenue bonds should be structured to generally provide level annual debt service over the life of the issue. Interest only payments during the early years of the project may be considered if in the best interest of the City.

(d) Debt Service Reserve Funds should be funded in cash or with a surety policy when required by rating agencies, bond insurers or existing bond covenants.

(e) Interest earnings on reserve fund balances, if any, will be used to pay debt service on the bonds unless otherwise committed for other uses or purposes of the project as described in the official statement.

(f) Revenue bonds issued for utility purposes will only be undertaken after an independent rate or fee study determines that net revenues will be sufficient to provide at least 1.2/1 coverage with respect to annual debt service.

(g) The City goal will be to maintain a minimum ratio of utility revenue to debt service of 1.2/1 or greater, to ensure debt coverage in times of revenue fluctuations attributable to weather or other causes, and to ensure a balanced pay-as-you-go Community Investment Program.

6.09 Improvement District (ID) Bonds

(a) ID bonds will be issued only when the formation of the district provides a clear and significant benefit to the City and the residents of the district. It is intended that Improvement District bonds will be issued primarily for discrete neighborhoods or master planned communities desiring improvements to their property such as roads, water lines, sewer lines, street lights, and drainage. Any such district must provide a specific benefit to the property owner(s). The City will review each project through active involvement of City staff and/or selected consultants to prepare projections, review pro-forma information and business plans, perform engineering studies, provide special assessment methodology analyses, analyze minimum debt coverage and value to debt ratios, and other analyses necessary to consider the proposal against specified criteria. ID bonds will be utilized only when it is expected that they will be outstanding for their full term.

(b) Improvement District debt will be permitted only when the full cash value of the property to be assessed, as reported by the Assessor's Office, is a minimum of three (3) times the indebtedness to be incurred prior to construction of the improvements. In addition, since ID debt is considered a contingent liability of the City, the City's aggregate annual improvement district debt service will not exceed five (5) percent of the City's annual general fund revenues. Bonds issued to finance improvement district projects will have maturities not to exceed twenty-five years.

6.10 Community Facility District (CFD) Bonds

Community Facility District bonds will be issued primarily for discrete neighborhoods or master planned communities desiring improvements to their property such as roads, water lines, sewer lines, street lights, and drainage according to the City's Community Facilities District Policy Guidelines.

6.11 Other Forms of Debt

(a) Interfund borrowing. The City may enter into Interfund loans rather than outside debt instruments to meet short-term cash flow needs. Interfund loans will be permitted only if an analysis of the affected fund indicates excess funds are available and the use of these funds will not adversely impact the fund's current operations. The prevailing interest rate, as established by the Finance Director, will be paid to the lending fund.

(b) Variable Rate Debt. The City may issue variable rate debt only after a careful review to assure that such issuance is prudent and fiscally responsible.

(c) Commercial Paper or Bond Anticipation Notes. The City does not intend to issue commercial paper (CP) or bond anticipation notes (BANs) for periods longer than two years or for the term of a construction project, whichever is less. If CP or BANs are issued for a capital project, the obligation will be converted to a long-term bond or other obligation or redeemed at its maturity.

(d) Short Term Debt. Short-term debt will be used only if the transaction costs plus interest are less than the cost of internal financing.

(e) Lease Obligations or Certificates of Participation. Lease obligations will normally be used for items of capital equipment exceeding $50,000, individually or in the aggregate. Lease purchase agreements or Certificates of Participation can be used to finance capital projects less than $10,000,000 or when timing or cost of capital considerations does not permit the issuance of GO or revenue bonds.

VII Maintenance Responsibilities

7.01 The City will maintain regular contact with rating agencies through meetings and visits on and off-site.

7.02 The City will seek to maintain and, if possible, improve any current bond ratings in order to minimize future borrowing costs and preserve access to credit.

7.03 The City will provide full public disclosure on a continuing basis to any national information repository following any underwritten debt issues.

7.04 The City will endeavor to maintain a ratio of current assets to current liabilities of at least 2:1 to ensure the City's ability to pay short-term obligations.

7.05 The City will endeavor to maintain a minimum cash reserve ratio of 20% for any fund from which revenues are pledged or which is responsible for paying debt service.

7.06 The City will endeavor to maintain a minimum debt service coverage ratio of 120% (1.2x coverage) unless debt covenants require a more restrictive, i.e. greater, ratio.