



Fiscal Policy Manual

POLICY DE-1: Policy for Debt Management

APPROVED: Board of Supervisors

AUTHORITY: Auditor-Controller-Treasurer-Tax Collector

ISSUE/REVISED DATE: February 7, 2017

I. Introduction / Purpose

The purpose of the County of Sonoma (the "County") Debt Management Policy (the "Policy") is to ensure sound and uniform practices for issuing and managing debt. The County recognizes that it may need to enter into debt obligations to finance projects and to meet fiscal responsibilities. Accordingly, this Debt Management Policy confirms the commitment of the Board of Supervisors (the "Board"), staff, advisors and other decision makers to adhere to sound financial management practices.

The County's Comprehensive Annual Financial Report lists a number of legally separate organizations ("component units") for which the Board is financially accountable. This Policy informs the actions of these component units to ensure a uniform approach to the issuance of debt.

II. Policy Objectives

The Policy objectives are as follows:

- Establish a systematic and prudent approach to debt issuance and debt management.
- Ensure access to debt capital markets and direct purchase investors (private placement providers) through prudent and flexible policies.
- Define specific limits or acceptable ranges for general fund supported debt and pension obligation debt.

III. Scope

This Policy governs the issuance and management of all debt and lease financing activity by County entities and component units. The debt policies and practices of the County are subject to and limited by applicable provisions of state and federal law and to prudent debt management principles.

The County uses financing techniques prescribed under existing law for projects that require financing beyond the current fiscal year. These techniques can include, but are not limited to, certificates of participation, lease-back arrangements, and revenue and assessment bonds.

IV. Debt Advisory Committee

The Debt Advisory Committee ("DAC") was formed by and is advisory to the County Administrator's Office ("CAO"). The Debt Advisory Committee ("DAC") is responsible for reviewing all proposed financing and providing the County Administrator's Office ("CAO") with a recommended course of action. The DAC may utilize the services of an independent Financial Advisor when analyzing proposed financing.

The DAC consists of seven members: (1) Auditor-Controller-Treasurer-Tax Collector (Chair), (2) County Administrator (Vice-Chair), (3) County Counsel, (4) Director of General Services, (5) Chief Engineer of the County Water Agency, (6) Executive Director of the Community Development Commission and (7) Assistant Treasurer. Members may specify an alternate to act in their place. Additional operating policies for the DAC are found under Section 1-3 of the Administrative Policy Manual - Policy for Debt Advisory Committee (Appendix A).

V. Delegation of Authority

Government Code § 53635.7 requires that all borrowing be placed on the Board Agenda as a separate item of business. This Policy requires that the Board specifically authorize each financing proposal based on the recommendation of the CAO. Policy implementation and the day-to-day responsibility for and authority over the County's debt program will lie with the Auditor- Controller-Treasurer-Tax Collector (the "ACTTC") and that office's Revenue and Debt Division Manager (the "Debt Manager") with participation by County Counsel and other departments as necessary. The ACTTC and Debt Manager will be supported on an as-needed basis by other members of the financing team and a Financial Advisor. The services of other outside consultants may be retained if necessary.

This Policy will be reviewed annually and updated as necessary. Any changes to the Policy are subject to approval by the DAC and the Board. The revised Policy will be provided to all County entities and component units. While adherence to this Policy is required, the County recognizes that changes in capital markets, County programs, and other unforeseen circumstances may produce situations that are not covered by this Policy. This may require modification or exceptions to achieve Policy objectives. In these cases, flexibility is appropriate, provided specific authorization from the Board or the component unit's Board of Directors is obtained.

VI. Standards for Debt Financing

The County will minimize the level of Direct Debt by incurring debt only in those cases where public policy, public interest and/or economic efficiency favor debt over cash financing or grant funding. In addition, the County shall use self-supporting (debt-service neutral or better) debt when possible. All debt issuance will fall within the limits permitted by the California Constitution and state law.

a. Relationship of Debt to Capital Improvement Program and Budget

The County is committed to long-term capital planning and intends to issue debt for the purposes stated in this Policy including any policy decisions incorporated in any applicable capital budget and the capital improvement plan. The County in most cases will issue debt to finance capital projects.

b. Other Potential Reasons to Issue Debt

Other possible reasons to issue debt include (but are not limited to) refinancing unfunded pension liabilities, allowing the County to cover periods of temporary cash shortfalls, refinancing bonds, and paying obligations imposed by law. Except to alleviate cash-flow timing issues within a fiscal year, the County will avoid using debt to finance reoccurring operating expenses. **Policy Goals Related to Planning Goals and Objectives**

The County is committed to long-term financial planning, maintaining appropriate reserve levels and employing prudent practices in governance, management and budget administration. The County intends to issue debt for the purposes stated in the Policy and to implement policy decisions incorporated in the County's annual operations budget.

It is the policy goal of the County to protect taxpayers, ratepayers and constituents by utilizing conservative financing methods and techniques so as to obtain the highest practical credit ratings (if applicable) and the lowest practical borrowing costs.

d. Credit Ratings

Without compromising the County's objectives, the County will work to ensure that all debt issuances receive the highest credit ratings possible. In addition, the County will attempt to maintain or improve the credit ratings of outstanding bonds.

e. Debt Issuance Requirements

All debt is required to undergo a DAC review before receiving the recommendation of the CAO and the approval of the Board.

All debt will be limited by the constraints described in Section IX, "Debt Level / Affordability Targets."

f. Method of Sale

The County's goal is to protect the public's interest by obtaining the lowest possible interest cost. To obtain this goal, the County may use a competitive, negotiated, limited-competitive (hybrid) or private placement method of sale. The appropriate method should be determined on a case-by-case basis.

Before selecting a method of sale for public offerings, the financing team shall take into consideration the current market, the issuer's characteristics, and the proposed bond structure. Market considerations will focus on the supply and demand of competing issuances. Issuer characteristic considerations will include market familiarity, credit strength, and policy goals. Bond structure considerations will include the type of debt instrument, issue size, structure, and timing.

The County prefers the use of a competitive sale for public offerings. However, if the Financial Advisor believes that pre-sale marketing will enhance the County's ability to sell the bonds to the public, the financing team should evaluate the benefits and legality of a limited-competitive or negotiated sale.

Due to the limited liquidity of private placements, public offerings will typically offer a lower cost of funds. Private placements are typically utilized for smaller issuances, more complex bond structures, or financings with short lead time.

g. Derivatives

A derivative product is a financial instrument which derives its own value from the value of another instrument, usually an underlying asset such as a stock, bond, or an underlying reference such as an interest rate. Derivatives are commonly used as hedging devices in managing interest rate risk and thereby reducing borrowing costs. However, these products bear certain risks not associated with standard debt instruments. Accordingly, derivative products should only be employed after careful evaluation of potential benefits and risks with prior DAC and Board approval.

h. Bond Counsel and Financial Advisor Requirements

Where appropriate, Bond and/or Disclosure Counsel and a Financial Advisor will be engaged.

i. Economies of Scale

The County will bundle projects into fewer transactions to achieve economies of scale associated with costs of issuance when feasible. In addition, the County will seek to optimize the use of assets used as underlying collateral when considering any new debt issuance.

j. Arbitrage Regulations

Generally, tax-exempt bond issues are subject to IRS arbitrage rebate requirements. These requirements specify that any profit or arbitrage be rebated to the Federal Government. Rebate computations are typically required every five (5) years and upon final redemption or maturity of the bonds. Any excess earnings are required to be rebated to the Federal Government.

k. Arm's Length Transactions

The County will endeavor to have "Arm's Length Transactions," in which the buyers (underwriters) of the debt have no relationship with the County. For Arm's Length Transactions, the County and the buyer are both acting in their own self interest and are not subject to any pressure or duress from the other party.

VII. Purpose of Debt

There are two basic types of debt: new money financings and refunding financings.

a. New Money Financings

The County may issue long-term debt in order to generate funding for capital projects. Short-term debt may be issued to generate funding for cash flow needs.

b. Refunding Financings

Refunding bonds are issued to retire all or a portion of an outstanding bond issue or other debt. Such bonds can be used to achieve present value savings on debt service, to modify interest rate risk, or to restructure the payment schedule, type of debt instrument used, or covenants of existing debt. The County must analyze each refunding bond on a present value basis to evaluate the economic effects. Policies on the administration of refunding bonds are detailed in Section VI.k. "Refunding Bonds".

VIII. Types of Debt / Terms of Debt – New Money

There are a variety of debt structures that the County will consider to meet its funding needs.

Short term debt includes tax and revenue anticipation notes (TRANS), commercial paper, grant anticipation notes, bond anticipation notes and lines of credit. Long term debt structures include, but are not limited to, general obligation (GO) bonds, special assessment district bonds, lease revenue bonds, certificates of participation, enterprise revenue bonds, sales tax revenue bonds, asset securitizations and pension obligation bonds (POBs).

The County may also participate in conduit financing, in which the Board may approve the issuance of bonds for the purposes of commercial, industrial, or residential property development. This type of financing does not create a liability for the County.

a. Debt Terms – New Money

Term and Structure: Long-term debt financing of capital projects will be for a period not to exceed 120% of the expected average useful life of the assets being financed, and in no event should exceed thirty (30) years. Debt Service will be structured to be level over the length of the bonds except in those instances where it is economically advantageous to the County or meets other County objectives to structure debt service differently. Short term debt and structure will be determined on a case-by-case basis and will be consistent with appropriate legal and tax requirements.

Coupon Premiums and Discounts: Coupon Premiums and Discounts shall be determined on a case-by-case basis as recommended by the Financial Advisor.

Call Provisions: Debt will be structured with the shortest possible Optional Call consistent with optimal pricing and County objectives.

Debt Service Reserve Fund: For long term debt and where appropriate for short-term debt, a Debt Service Reserve Fund will be utilized to achieve optimal pricing. Alternately, a Surety Bond may be evaluated and used if found to be economically advantageous.

Capitalized Interest: All interest due from the date of debt issuance may be rolled into principal until substantial completion of the project being funded unless another asset pledge or other sources of funds are available.

Variable Rate Debt: To maintain a predictable debt service burden, the County will give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is floating or variable rate debt. It may be appropriate to issue short-term or long-term variable rate debt to diversify the County's debt portfolio, reduce interest costs, provide interim funding for capital projects or improve the match of assets to liabilities.

Budgetary safeguards should be in place before incurring variable rate debt, and such debt should never amount to more than 20% of all outstanding debt. Before incurring variable rate debt, careful consideration should be given to current market conditions and trends, including the costs and availability of Liquidity Facilities. The County's cost for administering variable rate debt should be considered when comparing fixed and variable rate debt.

Credit Enhancement: The County will consider the use of credit enhancements on a case-by-case basis, evaluating the economic benefit versus the cost for each case. Bond insurance, stand-by letters of credit and other credit enhancements should be used only when they clearly demonstrate a net present value savings to the County.

Senior/Subordinate: Senior and Subordinate debt will be utilized in a manner that will minimize the costs of financing or maximize debt capacity.

IX. Refunding Bonds (Debt Refinancing)

The County is responsible for acting upon refunding opportunities that offer significant savings over the maintenance of existing debt.

Periodically, the County will analyze and evaluate debt repayment opportunities based on current market conditions. Additionally, the County may request or receive analysis of an opportunity to refund existing debt from a Financial Advisor or other municipal financial market participant. The County will consider such opportunities and evaluate the economic benefit they may present.

a. Debt Service Savings

The County has established a minimum present value cash flow savings threshold goal of three (3) percent of the refunded bond principal amount. A refinance may also be considered if other compelling reasons exist.

The present value savings will be net of all costs of the refinancing, will consider the difference in interest earnings of the debt service reserve funds of the refunded and refunding bonds, and may include any cash associated with the refunded bonds held by the Trustee. The decision to take the savings on an upfront or deferred basis must be approved by the Board after recommendation by the DAC and the CAO.

b. Guiding Principles

In evaluating refunding opportunities and applying the above referenced guidelines, the DAC and staff shall also consider the following:

Adjustments to the savings threshold for Advance Refundings, may be justified based on the length of time before the call of the bonds to be refunded. The longer the escrow, the higher the savings threshold should be. Conversely, shorter escrows may justify a lower savings threshold.

The County should consider a forward refunding to preserve the ability to advance refund the bonds at a future date for Advance Refundings with very short escrows.

Adjustments to savings thresholds for both Advance Refundings and Current Refundings, may be justified based on:

- the length of time from the call to maturity. The longer the time to maturity, the higher should be the savings threshold. Conversely, a shorter time to maturity may justify a lower savings threshold.

- interest rates at the time of the refunding relative to historical markets. In low interest rate markets a lower threshold may be justified while a higher threshold would be justified in high interest rate markets.

The coupon structure and/or callability of the refunding bonds may also justify adjustments to the savings threshold. Non-callable refunding bonds, for example, might justify a higher threshold.

c. Restructuring

The County will refund debt when it is in its best interest to do so. Refundings will include restructuring to meet unanticipated revenue expectations, terminate Swaps, achieve cost savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants.

d. Term of Refunding Issues

The County will refund bonds within the term of the originally issued debt. However, the County may consider maturity extension to achieve a desired outcome, provided that such extension is legally permissible. The County may also consider shortening the term of the originally issued debt to realize greater interest savings.

e. Escrow Structuring

The County shall utilize the least costly securities available in structuring refunding escrows. The County will examine the viability of an economic versus legal Defeasance on a net present value basis. A certificate from a third party agent, who is not a broker-dealer, is required. Said certificate must state that the securities were procured through an arm's length, competitive bid process (in the case of open market securities); that such securities were more cost effective than State and Local Government Obligations; and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an Underwriter, Agent or Financial Advisor sell escrow securities to the County from its own account.

f. Arbitrage

The County shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refundings. Any resulting positive arbitrage will be rebated according to Federal guidelines.

X. Debt Structuring Practices

The following standard terms shall be applied to all County debt transactions as appropriate. Based on the market condition at the time of the transaction, individual terms may need to be altered.

Characteristic	General Obligation Bonds	Lease Revenue Bonds	Certificates of Participation
Term	20 Years per issuance/series	Up to 20 years depending on the cash flow assumptions, construction timeline and remaining useful life of the asset being financed	20 years standard but not to exceed the remaining useful life of the asset being financed
Maximum Yield	Between 6 – 8%	Between 6 – 8%	Between 6 – 8%
Maximum Premium	Case by case as recommended by FA	Case by case as recommended by FA	Case by case as recommended by FA
Maximum Discount	None	None	None
Payment Dates	Fixed – Bi-Annual	Fixed – Bi-Annual	Fixed – Bi-Annual
Coupons	Fixed Rate	Fixed Rate	Fixed Rate
Call Provisions	Shortest possible option call consistent with optimal pricing	Shortest possible option call consistent with optimal pricing	Shortest possible option call consistent with optimal pricing
Structure of Debt	Level debt service	Level debt service – unless otherwise dictated by underlying remaining useful lives	Level debt service – unless otherwise dictated by underlying remaining useful lives
Debt Service Reserve	None	Maximum annual principal and interest payment amount	Maximum annual principal and interest payment amount
Capitalized Interest	None		
Reimbursement Resolution	Adopted by the Board of Supervisors	Adopted by the Board of Supervisors	Adopted by the Board of Supervisors
Good Faith Deposit	Lesser of 125% of cost of issuance or 1% of par amount	Lesser of 125% of cost of issuance or 1% of par amount	Lesser of 125% of cost of issuance or 1% of par amount
Budgeting Debt Service	Debt service shall be included in the tax levy	Budget shall be for gross debt service and the responsibility of the sponsoring department	Budget shall be for gross debt service and the responsibility of the sponsoring department

XI. Debt Level / Affordability Targets

The County shall establish an affordable level of debt in order to preserve credit quality and ensure financial stability. As such, aggregate General Fund lease debt service should fall within a range of four to six percent (4%-6%) of General Fund Expenditures¹. The County shall maintain a debt affordability model with ratios recalculated at the time of a new debt issue. The DAC and the Board will be notified if any new issuance would cause the ratio to exceed the threshold. Both DAC and Board approval would be required before the County is allowed to exceed the ratio threshold.

A component unit may be allowed to exceed the above target ration if the unit generates user fees through a business-type activity. The component unit must, however, repay the debt with money generated by user fees or other dedicated revenue sources.

The above target ratio does not include POB debt service or the County's pension and retiree health care unfunded actuarial accrued liabilities (UAAL), which itself is a form of "debt" owed to retirement plan members. POB's are used to refund the county's UAAL at a lower cost to achieve cost savings and shall be issued only after careful consideration by the DAC and Board of potential benefits and risks. Considerations shall include: (i) the spread between the expected borrowing rate and the assumed rate of return on retirement plan assets; (ii) investment risk associated with the investment of POB proceeds; (iii) issuing a sufficient amount of POBs to generate market interest; and (iv) the County's overall pension burden, including both POB debt and UAAL. The County has established that the debt service for POBs should not exceed 5%-7% of total County expenditures, without consideration of UAAL. To the extent that rating agency or other metrics are available, the County's pension burden shall be compared to that of other comparable agencies.

XII. Financial Assistance

The County may be approached by organizations seeking financing for projects or to satisfy temporary cash flow shortfalls that exist between periods of expenditure and revenue generation. The County has established a set of guidelines (see Appendix B, "County of Sonoma Financial Assistance Guidelines") to govern such requests.

XIII. Discount Rate Reduction

The discount rate for employee pension obligations will be evaluated periodically by the County. The impact of modifying the discount rate will be compared with the costs and benefits of allowing the rate to remain static. During stock market boom cycles, increased returns are often utilized to ensure the retirement systems funding status, reduce outstanding debt where allowable, and bolster the trust fund against uncertainty.

XIV. Annual Reporting / Continuing Disclosure

The County will prepare an annual debt obligation report (the "Report") for distribution to the DAC, CAO, Board, and general public. The Report will include:

- the total County debt as of June 30 of that year.
- each debt obligation's interest rate, term, and annual payment.
- any refinancing that occurred that year.

All existing County debt should be compliant with Continuing Disclosure Certificate requirements. All future debt issues should also be compliant.

Each responsible County department, agency, district or authority issuing or managing debt will:

- observe all applicable state and federal regulations and laws regarding disclosure.
- file all annual reports and material event notices with the appropriate agencies in a timely manner.
- file a Material Event notice pursuant to Rule 15c2-12 under the Securities Exchange Act of 1934.

The County will conduct "due diligence" meetings with all relevant County staff prior to the issuance of new bonds and notes. A Preliminary Official Statement will be released to the market only after the completion of the "due diligence" meetings.

XV. Internal Control Procedures

Proceeds of debt will be held either (a) by a third-party trustee, which will disburse such proceeds to the County upon the submission of one or more written requisitions, or (b) by the County, to be held and accounted for in a separate fund or account, the expenditure of which will be carefully documented by the issuing entity.

XVI. New Financing Methods and Techniques

Changing federal regulations and the shifting concerns of rating agencies mean that Counties operate in a dynamic financial environment. This Policy is not intended to hinder the County's use of any new financing techniques that may arise.

Proposals for financing methods not included in this Policy should be addressed to the DAC. If the DAC approves of such financing methods, the DAC should recommend their use to the CAO. This Policy should then be amended to reflect any new financing techniques recommended by the DAC and approved by the Board.

XVII. Conclusion

This Policy is intended to guide and regulate the County's issuance of debt. The County is aware, however, that the financial environment may change and that this Policy may therefore require a review or update. Should circumstances dictate, this Policy should be modified to remain relevant in the current financial environment.

Appendix A

[Under: 1-0 General Administration & Organization or 3-0 Budget and Fiscal]

1-3 Policy for Debt Advisory Committee

Approved:

Authority:

Revised Date:

I. Purpose

The Debt Advisory Committee was formed by and is advisory to the County Administrator's Office. The Debt Advisory Committee (the "Committee") is charged with protecting the County's financial well-being and strong credit rating by assisting County departments or other government entities under the jurisdiction of the Board of Supervisors ("component units") in placing debt.

II. Policy

A. General Provisions

1. Function

The Committee's primary function shall be to review any proposed financing of \$500,000 or more initiated by a County department or a component unit and make a recommendation as set forth in this document.

"Financings" shall mean any bonds, certificates of participation, lease-purchase agreements, notes, interest rate swaps, letters of credit or other financing arrangements in an amount of \$500,000 or more that will create a long-term liability for the County or a component unit.

2. Scope

At the County Administrator's request, the Committee will also review and make recommendations on other financing issues. Issues and questions which the Committee will research and review include, but are not limited to, the following:

- a. The total level of debt obligations within the County. For purposes of this policy, debt is defined to include financing techniques legally available to the County for projects that require resources beyond the current fiscal year. The Committee should consider any resulting burden on County taxpayers and the maintenance of the County's financial strength and credit ratings.
- b. The level of debt of overlapping jurisdictions.
- c. The appropriateness of a given type of debt instrument for a financed project.
- d. The structure of a given financing, including maturity, amortization, security, interest rates, rating, risk, and any other parameters the Committee deems appropriate.

e. The debt levels of County departments and agencies.

f. The status of existing debt issues, including such matters as refunding possibilities, administration costs, and adherence to covenants.

B. COMMITTEE

1. Committee Members

The Committee shall consist of the following individuals or their alternates:

a. County Administrator

b. County Counsel

c. Auditor-Controller/Treasurer-Tax Collector

d. Director of General Services

e. Chief Engineer of the County Water Agency

f. Executive Director of the Community Development Commission

g. Assistant Treasurer (Auditor-Controller/Treasurer-Tax Collector's Office)

2. Alternates

Any officer named in B.1., above may designate an alternate to act as a member of the Committee in his or her stead. For all interests and purposes, it will be as though the officer were personally present. The alternate will possess the rights to participate in the proceedings of the Committee and to vote upon any and all matters.

3. Chair and Vice-Chair

The County Auditor-Controller-Treasurer-Tax Collector or his or her alternate will chair the Committee. The County Administrator or his or her alternate will act as the Vice Chair. The Chair shall be responsible for providing the functions of a recording secretary if the Committee deems such services to be necessary.

C. COMMITTEE MEETINGS

Any member will have the right to propose a meeting of the Committee. After a member proposes a meeting, the Chair shall call a meeting, prepare an agenda and notify all members of the Committee as soon as is practical.

The Committee may also conduct business using a digital voting process if a live meeting is not practical.

D. COMMITTEE FINDINGS AND REPORT TO THE ADMINISTRATIVE OFFICE

1. Committee Review

The Committee will determine the feasibility of project financing, the financing program, and the program's compliance with County policy following consideration of all material submitted, both written and oral. The Committee reserves the right to require subsequent reviews of each financing project prior to the sale of bonds to ensure that all provisions of the policy are being met.

2. Recommendations

The Committee will record its recommendations after taking action pursuant to Section 1 of this chapter. County departments and component units will include the Committee's recommendations to the CAO in their report to the Board of Supervisors.

3. Waivers and Modifications

The Committee, with concurrence of the County Administrator, has the right to waive or modify any of the policies included herein, if, in its judgment, the County and its residents would benefit from such waiver or modification.

E. ITEMS SUBMITTED TO COMMITTEE FOR REVIEW

The County department or component unit requesting the Committee's review shall submit the following information to the Committee Chair:

1. A description of the project or facilities to be financed.
2. A description of the source of revenue for debt retirement, including a statement regarding the liability of the County and the Board in the event of a default.
3. A summary of the public review process, if any, and the actions the Board will be required to take.
4. A schedule of financing activities.

5. Identification of administrative tasks and responsibilities necessary for debt service administration and covenant compliance.

All information must be received at least one week prior to the review.

Appendix B

County of Sonoma Financial Assistance Guidelines

Periodically, a County Supervisor, the County Auditor-Controller/Treasurer-Tax Collector (the “County Treasurer”), or the County Administrator is approached by organizations seeking financing for various projects and programs. Predominantly, requests are made for short term, temporary funding, to fill the gap of time between current expenditure needs, and an unrealized future source of funding.

The following guidelines will help the reader better understand what legally acceptable avenues of financial assistance/support exist for these requests. If you have any questions regarding how to interpret these guidelines, please call the Revenue & Debt Division Manager, Jonathan Kadlec, at 565-6124.

The County Treasury

1. Temporary Transfers (California Constitution, Article XVI, § 6)

The California Constitution allows the County Treasurer to make temporary transfers to any city, district, or political subdivision whose funds are in the custody of the County Treasury. Transfers can only be made from July 1 through the last Monday in April of the current fiscal year, and must be repaid from revenues prior to any other obligation of the borrower. On July 1, the amount of the advance may be up to 85% of anticipated revenues accruing within the current fiscal year. All transfers must have the prior approval of the local governing board of the borrowing entity. In addition to the repayment of principal, the borrowing entity must also pay the Treasury pooled rate of interest on the principal amount of outstanding indebtedness, up until the repayment date.

On February 20, 1991, the Sonoma County Board of Supervisors approved resolution #90-0271 delegating authority to the County Treasurer to approve temporary transfers, secured wholly by funds collected through the property tax system. Any other outside source of revenues used to secure a transfer must receive both approval of the borrowing entity’s local board, and the County Board of Supervisors.

2. County Treasury Investments – Local Agency Debt (Government Code § 53601(a) and (d))

From time to time local government agencies may issue bonds, notes, warrants or other evidences of indebtedness that the County Treasurer may invest in, provided that the County Treasurer deems the investment to be secure, and provided the investments meet all other investment criteria as outlined in the County Treasurer’s Investment Policy, as approved by the Board of Supervisors. The following are the basic criteria for this type of investment:

A. The local agency must have the legal authority to issue the indebtedness. For example, pursuant to GC § 53850 et seq., local government agencies are authorized to issue tax revenue anticipation notes (TRAN). The Treasury requires the issuing agency’s counsel to write a letter verifying that the agency has the authority to issue the note, and specifying the statutory authority that applies.

Pursuant to GC 53635.7, the County Treasurer will also require the local governing board to have discussed and deliberated each borrowing decision of \$100,000 or more, prior to issuance of the proposed indebtedness.

B. There must be a secure source of repayment for the protection of the Treasury Pool participants. Valid sources might include a final grant award, revenue streams such as sales tax money, fees or charges that meet or exceed the repayment period, an agency general fund, or other secure sources subject to review and approval by the County Treasurer.

C. In no event is the County Treasurer permitted to purchase investments with a remaining term to maturity of five years or more, unless the County Board of Supervisors has granted the express authority to make that specific investment, or as part of an investment program approved by the Board at least 3 months prior to the investment.

The County

After considering other first line financing options such as CSAC's California Communities Joint Powers Authority, commercial banks or other funding sources, the County may use debt as an alternate means of financial assistance in two ways, either as an issuer of debt or a purchaser of debt. In general, debt is divided into two categories, short term and long term. By definition, short term typically means 13 months or the end of the current fiscal year, and long term debt is greater than 13 months or beyond the end of the current fiscal year.

A. Short Term Debt Issuance

Pursuant to GC § 53820, 53840 & 53850 et seq., short term debt instruments such as a TRAN (Tax Revenue Anticipation Note), GAN (Grant Anticipation Note), or BAN (Bond Anticipation Note) may be issued by approval of the Board of Supervisors. Notes are typically issued to bridge a cash flow shortage for a specific project or need.

B. Long Term Debt Issuance

The County may not issue long-term debt, meaning any type of debt instrument with maturity of 13 months, or greater than the end of the current fiscal year, without a two-thirds majority vote of the citizens of Sonoma County. Examples of debt subject to this limitation include GO bonds or Revenue bonds. There are exceptions for lease instruments (certificates of participation, or "COP's", and master lease-purchases), where the county is annually paying for value it receives, and the debt cannot be accelerated. These instruments are quite complex and bond counsel is normally retained to draft the documents. A lease-purchase borrowing of \$500,000 or more is only used when financially prudent, and at the recommendation of the CAO and the Debt Advisory Committee, and with Board approval, in order to finance significant capital improvement projects such as buildings, building improvements or major systems acquisitions. Lease-purchases

under \$500,000 are subject to normal County Purchasing guidelines and approvals.

C. Debt Purchase

Pursuant to GC § 53601, the County may also purchase or invest in debt instruments of local agencies or districts. The types of investments are also defined by GC § 53601. Consideration of this option means that the County Treasurer within his fiduciary responsibility cannot purchase the contemplated debt as an investment under the Treasury investment policy guidelines. Inherently, the debt is less secure than Treasury investments and thus shall be subject to underwriting guidelines in order to be considered for purchase (See Appendix C). Use of this option should be for the purposes of accomplishing an overriding public policy goal. The issuing agency must also demonstrate that they have the legal debt capacity to issue the debt being considered. For the protection of the County, any type of debt purchased must have a clearly defined, legal source of repayment and collateral. Use of this option as a means of financial assistance is dependent upon the General Fund having sufficient cash flow available after all reserve and operational cash flow obligations are met. Because of the potential risk to the General Fund, the County Treasurer and County Administrator shall be consulted in conjunction with this option, and a recommendation presented to the Board of Supervisors.

Other

Notwithstanding the previous guidelines, pursuant to GC § 26227, the Board of Supervisors may appropriate and expend money from the general fund of the County, or any other fund under their authority, to establish or fund programs deemed necessary to meet the social needs of the population of the County. Purposes allowed under this code section are broad and sweeping in nature. If consideration for financial assistance for a specific need outside of the funding of normal County operations is being contemplated, then a policy determination will have to be made to approve the proposed financing program. Assistance of this type must be processed in the normal budgetary process using ordinary budget controls.

Summary

In particular, any type of financial assistance provided through a method that poses a potential liability to either the General Fund or the Treasury Pool should at a minimum follow the aforementioned guidelines. In addition, these requests should generally be considered only when the following criteria can be met:

- 1) Safety of Funds – Protection of principal
- 2) Liquidity of Funds
- 3) Yield or Fair Return on Investment
- 4) Public Benefit

An evaluation of each request should be made on a case by case basis, with the goal of meeting these criteria. Please refer to Appendix C for underwriting guidelines to be used as a starting point. In general, the highest priority will be given to the safety and protection of principal, and each request will be evaluated using items #1-3 of the underwriting guidelines. If a request cannot meet the safety of principal test then no further evaluation is needed as the request will be denied. If the request meets the safety of principal test, then a further analysis of liquidity and yield will be performed using items #4-6 of the underwriting guidelines. Finally, a discussion of public benefit will be balanced against the other factors in arriving at a final decision. In all cases the County will require that proper documentation is provided and under no circumstances will subordination be allowed (#7 and #8 underwriting guidelines).

Appendix C

Underwriting Guidelines

The following criteria are factors that will be considered in order to qualify any County purchase of debt issued by an outside agency. This is not necessarily a comprehensive set of guidelines and there may be additional factors that are unique to the nature of a debt issue that need to be considered on a case specific basis.

1. Acceptable Collateral - Primary

- A. Tax Revenue (Parcel Tax, Sales Tax or Property Tax)
- B. Grants or Subsidies in favor of the County

2. Secondary Collateral

- A. Real Property
- B. Bank Secured Letter of Credit
- C. Acceptable Securities
- D. Cash Reserve or equivalent

3. Debt Service Coverage Ratio

The Debt Service Coverage Ratio which is, defined as the ratio of Net Annual Operating Revenues to Annual Debt Service, should be 1.25 times or greater.

4. Term

The term of any debt purchase by the County must be five years or less unless the Board of Supervisors approves a term of greater than five years.

5. Rate

The rate on any debt purchased shall not be less than the current County Treasury Pool rate plus administrative costs to manage the debt purchase.

6. Size

The size of a debt purchase is dependent upon the General Fund having sufficient cash flow available after all reserve and operational cash flow obligations are met.

7. Documentation

At a minimum, any purchase of debt requires an opinion letter from Bond Counsel that the debt is issued in accordance with relevant State law, a Purchase Agreement, a Promissory Note and any other documents deemed necessary to the transaction. All documentation will be subject to review by County Counsel.

8. Subordination

The County will not subordinate its repayment priority to any other debt issued subsequent to that debt being purchased by the County.

Appendix D – Glossary

Advance/Current Refunding. A financing technique that typically allows an issuer to obtain the benefit of lower interest rates or an alternate bond structure when the outstanding bonds are (1) not currently callable (advance refunding) or (2) are currently callable (current refunding). For an advance refunding, the proceeds from the sale of the refunding bonds are used to purchase taxable government securities, which are deposited in an escrow account. The escrow account is structured so that the principal and interest earned on the securities are sufficient to pay all principal, interest, and call premium, if any, on the outstanding bonds, up to and including the call date. For a current refunding bond, proceeds are immediately used to pay principal, interest and call premium, if any, on the outstanding bonds. The refunding bonds are secured by the same sources of taxes or revenue previously pledged to the payment of the outstanding bonds.

Arbitrage. The difference between interest cost and interest earnings.

Business-type activities. Functions of the County that are intended to recover all or a significant portion of their costs through user fees and charges. Examples of business-type activities of the County include Refuse, the Sonoma County Water Agency and Airport.

Capitalized Interest. A portion of the bond proceeds set aside to pay interest on the bonds for a specific period of time. During the construction phase of a project interest is commonly capitalized so that debt service does not begin until project completion.

Certificates of Participation. A method of structuring and distributing tax-exempt leases to investors by dividing the rental payments and lease into fractionalized interests or shares for individual sale to investors. The share is represented by a formal certificate, much like a bond. COPs can be placed privately or sold publicly. COPs generally are sold for large asset financing and tend to be used more for real property rather than personal property acquisitions.

Continuing Disclosure Agreement. The agreement by a municipal bond issuer to disseminate annual financial information and material event disclosures to the information repositories as defined by the Municipal Securities Rulemaking Board (MSRB).

Coupon. The interest rate stated on the bond when it is issued.

Coupon Premiums. A couponing structure where the yields on the bonds are lower than the stated interest rates. This structure is typically preferred by institutional investors.

Coupon Discounts. A couponing structure where the yields on the bonds are higher than the stated interest rates. This structure is typically preferred by retail investors.

Debt Service. The periodic payment of principal and interest on debt.

Debt Service Reserve Fund. A fund that is held in trust until bonds mature. The fund will be utilized in the event that an issuer cannot make debt service payments.

Defeasance. A provision that voids a bond or loan when the borrower sets aside cash or replacement bonds sufficient enough to service the remainder of the borrower's existing debt.

Derivative. A financial instrument whose value depends on the value of an underlying asset, an index or a reference rate. Examples are swaps and options.

Direct Debt. An obligation arising from the borrowing of money to be repaid over a period of time. If the money is borrowed over a multi-year period, the repayment will be subject to state and local constitutional provisions, statutes, and judicial and administrative determinations. Direct debt includes voter-approved general obligation bonds, pension obligation bonds, unfunded pension benefit obligations, tax-supported lease obligations, capital leases paid from governmental funds and internal service funds, special assessment debt with a contingent County obligation, and other tax-supported bonded obligations. Tax and revenue anticipation notes are not classified as direct debt.

Escrow. Money held by a third party on behalf of the other two parties in a transaction.

Governmental-type activities. Functions of the County that are principally supported by taxes and intergovernmental revenues. Examples of governmental activities of the County include general government, public protection, public ways and facilities and public assistance to name a few.

Gross Funded. Sizing the initial deposit into a fund in the total amount required. Interest earning will then be used for other purposes.

Lease Debt. Lease debt, or Lease Purchase Financing, represents long-term financing suitable for capital expenditures, including the acquisition or improvement of land and facilities. In California, tax-exempt leases with non-appropriation or abatement clauses are not considered debt under the Offner-Dean rule, though they act as debt in a financial sense. Examples of lease debt include lease revenue bonds, sale-leaseback arrangements, operating leases, and certificates of participation.

Lease Revenue Bond. A lease revenue bond (or a lease-backed revenue bond) is a bond which is repaid through regular lease payments from project revenues. General Fund revenues may also be used to make lease payments.

Liquidity Facility. A line of credit, letter of credit, standby purchase agreement or similar facility, issued by a commercial bank, insurance company, or other financial institution, and delivered or made available to the Trustee for a bond issue.

Material Event. Certain events affecting a municipal security (bond) as defined under a continuing disclosure agreement meeting the requirements of Rule 15c2-12. Material Events are specifically defined for each municipal bond offering in the Continuing Disclosure Agreement.

Net Funded. A fund whose initial deposit is less than the total amount required for all related projects. The fund's interest earning are then used to supplement the initial deposit.

Optional Call. Bonds that can be redeemed at the option of the issuer.

Principal. The amount borrowed or the amount still owed, separate from interest.

Private Placement Providers. Bond investors who purchase bonds directly from the issuer, a private placement or direct purchase. The alternative is a public placement where bonds are offered to the public and sold through an underwriter. Private Placement Providers are typically large banks, mutual funds, insurance companies and pension funds.

Sale-leaseback. An arrangement in which one party sells an asset to another party before leasing it back. The initial seller receives an infusion of cash from the sale of the asset but still retains its use. In many cases, the lease is structured to provide tax advantages to the original seller. This arrangement is frequently used so a party can finance capital expenditures or other programs with the equity in assets that they own.

Senior Debt. Senior Debt is repaid before Subordinate Debt.

Subordinate Debt. Subordinate Debt is repaid after Senior Debt.

Surety Bond. A form of bond insurance an issuer can purchase from a bond insurance company in lieu of maintaining cash in a reserve fund.

Swaps. Agreements made between two parties to exchange a stream of periodic payments. Swaps are used to minimize risks associated with unpredictable or fluctuating market factors.

Underwriter. A firm that buys securities (bonds) from an issuer and resells them to investors.

Yield. The effective rate of interest paid on a bond or note.