

DEBT MANAGEMENT POLICY

I. Statement of Purpose

The purpose of the City of Seguin, Texas Debt Management Policy (the "Policy") is to establish and maintain well defined debt management guidelines for issuing new debt as well as managing outstanding debt to sustain a strong debt management program.

II. Scope

The Policy applies to all debt instruments issued by the City regardless of the purpose for which issued or the funding source for repayment.

III. Objective

The primary objective is to ensure prudent debt management practices which include:

- Maintain financial stability;
- Preserve public trust;
- Minimize costs to taxpayers and ratepayers;
- Minimize borrowing costs;
- Preserve access to financial markets; and
- Maintain and improve the City's credit rating.

IV. Types of Authorized Debt

Through the issuance of debt obligations, a city can finance capital improvements for practically any public purpose. The types of debt obligations, **all hereafter discussed in more detail** generally include:

A. TAXING AUTHORITY

The authority for ad valorem taxation for Texas cities generally is provided for in Article XI of the Texas Constitution.

Article XI, Section 5 of the Texas Constitution is applicable to the City, and limits its maximum ad valorem tax rate to \$2.50 per \$100 assessed valuation for all City purposes. The City operates under a Home Rule Charter, which adopts this constitutional provision. The Texas Attorney General has adopted an administrative policy that generally prohibits the issuance of debt by a municipality such as the City if its issuance produces debt service requirements exceeding that which can be paid from \$1.50 of the foregoing \$2.50 maximum tax rate calculated at 90% collection.

1. General Obligation Bonds - payable from ad valorem taxes

General Obligation Bonds are covered above under Taxing Authority, except that general obligation bonds may only be issued upon obtaining the approval of the

residents of the city at a bond election. This election must be conducted in accordance with Texas Revised Civil Statutes Annotated Article 704, as amended, the Texas Election Code, and the city's Home Rule Charter.

2. Certificates of Obligation - three basic types:

- Certificates payable from taxes;
- Certificates payable from revenues; and
- Certificates payable from a combination of taxes and revenues.

If Certificates of Obligation are payable from ad valorem taxes, they are confined to the same tax limitation as General Obligation Bonds.

Certificates of Obligation require publication of a Notice of Intention and require no election unless a valid petition is presented calling for an election.

If Certificate proceeds are to be used for acquiring land or existing structures, they can be issued and sold for cash.

If Certificates are issued and the payment of debt service qualifies for a limited pledge of revenues other than ad valorem taxes, as from a combination of revenues and ad valorem taxes, the certificates can be issued and sold for cash to construct any public work, purchase equipment, land, and rights-of-way, and pay professional fees.

All Certificates are eligible to receive approval by the Attorney General of the State of Texas.

3. Tax Notes - payable from ad valorem taxes or revenues.

The authority for issuance of Tax Notes was approved by the Legislature in 1993, referred to as Article 717w, as amended, Texas Revised Annotated Civil Statutes.

The more salient features include:

- No election required;
- Can be issued to construct any public work, purchase equipment, land, and rights-of-way, and pay professional fees;
- Maximum maturity at time of issuance is 7 years;
- Can be accomplished on very short time frame; and
- The Attorney General will approve a refunding of the Tax Notes without a maturity limitation.

4. Revenue Bonds - payable from revenues generated from the use of certain facilities such as utilities (water, sewer, electric, gas), parks, airports and others.

Revenue bonds may be issued and generally are payable from "net" revenues realized from the operation of utilities. Legal authority and limitations for revenue bonds generally are found in Articles 1111 to 1118 of Vernon's Revised Civil Statutes.

Conditions governing the issuance of revenue bonds are customarily stipulated in the ordinance authorizing such bonds or previously issued bonds if they are issued on a parity lien.

Coverage Required as a Condition to Issuance of Parity Bonds: Based upon the City's outstanding bond ordinances, for the preceding fiscal year or for 12 consecutive months out of the 15 months immediately preceding the adoption of additional bonds ordinance, net revenues shall have been not less than 1.40 times average annual requirements, after giving effect of the additional bonds and 1.10 times maximum annual requirements after giving effect of the additional bonds. Rate changes in effect at least 60 days are considered in a pro forma statement calculating net revenues assuming rate changes were in effect for the entire period.

- V. Debt Finance Guidelines - The City will consider a range of debt structures which when combined allow for flexibility in responding to future needs, do not utilize all available debt capacity, continue to emphasize credit considerations, and match well with the useful life of the assets for which debt is incurred.
 - A. Debt is a financing tool which should be judiciously used within the City's legal financial and debt market capacities.
 - B. Debt Defined - The creation of debt occurs when a governing body incurs a financial obligation that cannot or will not be repaid from current year revenues.
 - 1. Cash Flow Financing - Cash flow financing refers to tax and revenue anticipation notes (TANS and RANS) that are issued in anticipation of the receipt of revenues, and the tax dollars are levied, appropriated, and expected to be received in the fiscal year in which the note is issued. TANS and RANS are payable from current year revenues and, therefore, do not constitute debt.
 - 2. Short-Term Debt - For purposes of this policy, short-term debt refers to debt with a repayment term of less than five (5) years.
 - 3. Long-Term Debt - For purposes of this policy, long-term debt refers to debt with a repayment term greater than the maximum term of short-term debt, up to the maximum term allowable by law.
 - C. Conditions for Which Long-Term Debt May Be Issued - When an asset's useful life is appropriate for long-term financing and the estimated future revenues are sufficient to insure repayment of debt obligations, long-term debt will be considered.
 - 1. Bonds - Capital requirements for the construction, acquisition, and equipping of facilities and infrastructure, and the purchase of necessary sites for facilities and infrastructure will be identified and formalized in a capital improvement program (CIP) subject to voter approval. The capital planning process may incorporate updated demographic data from a third party consultant, facility planning date

from Support Services and architectural firms, and debt financing data from the City's Financial Advisor and Chief Financial Officer (CFO).

2. Debt Refunding - The refinancing and/or restructuring of debt can be valuable debt management tools to provide the City with debt service savings or debt payment relief. Debt is often restructured through the issuance of refunding bonds. Current refunding occurs when the refunding bonds are settled within 90 days of an optional prepayment date. Advance refunding occurs when the refunding is settled more than 90 days in advance of an optional prepayment date. Federal restrictions allow an issue to be advance refunded only once on a tax exempt basis. The City will actively review, analyze, and pursue opportunities to refund outstanding debt.
3. Variable Rate Debt - Variable rate debt can be an important tool in managing a debt program. When issued prudently, variable rate debt may help lower the cost of borrowing and provide a hedge against interest rate risk. Interest rates on variable rate debt instruments are at the short end of the yield curve because they are periodically adjusted (e.g. daily, weekly, or monthly) based on current market conditions. Variable rate debt gives investors the right to "put" securities back to the issuer at their discretion at specified future intervals. When issuing variable rate debt (rather than fixed rate debt), the City will need additional parties involved including a Remarketing Agent, Liquidity Provider and Tender Agent. The Remarketing Agent determines the interest rate for the period, notifies the bondholders (through the Tender Agent) and remarkets any bonds tendered to either different bond buyers or the Liquidity Provider. The Liquidity Provider is usually a national or multi-national bank that provides the City with liquidity through a Standby Bond Purchase Agreement. Should there be a failed remarketing, the Bonds would be placed with Liquidity Provider until the bonds could be effectively remarketed. The Tender Agent would accept the tender bonds from the holders and notify the City, remarketing agent, liquidity provider and the bond holders of required mandatory or optional tender notices or rate changes.

As a general rule, some rating agencies recommend that variable rate debt not exceed 10-20 percent of total bonds outstanding, although other factors may affect their evaluation of the amount they regard as acceptable. The City may consider issuing variable rate bonds when variable short-term interest rates are consistently lower than long-term fixed rates. Total variable debt may not exceed 10% of the total outstanding debt, plus the amount of authorized bonds.

4. Unauthorized Structures - The City will not utilize swaps and other similar derivative products as a method of issuance.

D. Restrictions/Limitations of Debt Issuance:

1. Debt Tax Limitations - As stated earlier, the Attorney General has a policy not to approve any bonds that would require a debt service tax which would exceed \$1.50.

2. Maturity Levels - The weighted average life of the debt issuance should not exceed the useful life of the asset being financed, and in no case shall the final maturity of the issuance exceed the legal maximum of 40 years.
3. Repayment Provisions - The City will structure its debt in compliance with all federal, state, and local requirements as to repayment terms and seek to repay its debt in an expeditious manner within the City's overall financial objectives and in consideration of the useful life of the project and dedicated repayment revenue sources. The City will structure its debt with two primary goals: 1) to ensure the earliest possible maturity of the bonds, and 2) matching or improving upon the I&S tax rate assumptions and projections as discussed with the citizens of the City at the time of the bond election.

E. Debt Issuance Process:

Preferred Method of Sale - The City may use competitive sales, negotiated sales, or private placement as methods of sale for its debt issuance. When considering the method of sale, the City will take into consideration:

- Financial and market conditions;
- Transaction specific conditions; and
- City related conditions.

Competitive sales are the preferred method under the following circumstances:

- A general obligation pledge;
- Simple structure and financial analysis;
- Stable financial markets; and
- Moderate par amount.

Negotiated Sales are the preferred method under the following circumstances:

- Complex transactions that require extensive financial modeling, credit analysis, pre-marketing efforts, or that are interest rate sensitive; and
- Volatile financial markets.

Private Placement is the preferred method under the following circumstances:

- Smaller issue size; and
- Overall cost savings to the City.

Reimbursement Resolution - As provided by law, the City may decide that it is in the City's best interest to pass a Reimbursement Resolution prior to the formal issuance of debt. The purpose of such a resolution is to announce the intent to reimburse itself for expenditures related to the capital programs for which debt may, or will, be issued. This would allow the General Fund, or whichever fund the original expenditures were made from, to be reimbursed by bond proceeds once the debt is issued. The City will intend to

reimburse itself within 18 months from the later of the date the original expenditures or the date the project financed is placed into service.

1. External Financial Professionals:

a. Financial Advisor - The City's Financial Advisor will work with City staff to:

- Insure that the City's bonds are issued at the lowest possible interest cost and are structured in accordance with the City's financing guidelines;
- Prepare the Notice of Sale, Preliminary Official Statement, and the Official Statement;
- Evaluate the bids submitted and recommend that they be accepted or rejected;
- Review draft closing documents and monitor the closing process;
- Prepare and submit the City's Annual Disclosure Report in accordance with SEC Rule 15c2-12; and
- Assist in establishing repayment schedules that complement existing requirements and maintain a repayment pace acceptable to credit rating agencies.

b. Bond Counsel - The City's Bond Counsel will:

- Certify that the City has the legal authority to issue bonds;
- Prepare required orders, resolutions, and tax certificates;
- Work with the Attorney General to obtain approval of the bond issue;
- Provide a legal opinion as to the enforceability and the federal income tax implications of the bonds; and
- Coordinate the closing transactions.

c. Paying Agent/Registrar - The City's Paying Agent/Registrar will:

- Authenticate the bonds;
- Send/receive transfers of money at closing;
- Maintain a listing of bondholders and applicable addresses;
- Receive principal and interest payments from the City and remit to bondholders; and
- Represent bondholders in case of default.

d. Rating Agencies - The City will consider obtaining a credit rating from at least one nationally recognized bond rating agencies on all bond issues. There are currently three nationally recognized rating agencies: Moody's Investors Service, Inc., Standard & Poor's Rating Services, a Standard & Poor's Financial Services LLC, and Fitch Ratings, Inc. Rating agencies assign a credit rating to bonds based on their assessment of the City's financial position and ability to make full and timely payments of principal and interest, and provide a ratings report to the market prior to the sale.

2. Timing of Sales - The City's Financial Advisor will work with the City staff (Financial Services and Support Services) to insure that the timing of bond sales coincide with having bond proceeds available for projects prior to the execution of constructions or purchase contracts.
3. Bond Rating Goals - The City will strive to maintain excellent bond ratings through:
 - Strong financial management practices;
 - Timely disclosure of annual financial information, including Annual Financial Report prepared by management and attested to by the external auditors; and
 - Maintaining good relationships with bond rating agencies, including site visits or meetings in person when required.
4. Disclosure Requirements - The Securities and Exchange Commission (SEC) regulates both primary disclosure (the initial marketing of bonds and continuing disclosure (the ongoing information to the market about the status of the issue and issuer). The Securities and Exchange Commission Rule 15c2-12, as amended, requires the City to provide updated annual financial information no later than March 31st to the Municipal Securities Rulemaking Board through its Electronic Municipal Markets Access (EMMA) system. Timely and accurate information can improve the marketability of the City's bonds.

The City understands that it is their responsibility to comply fully with the Securities and Exchange Commission Rule 15c2-12, as amended. The City will work in conjunction with their Financial Advisor to prepare, complete, and file the required annual reports and any necessary event notices. Once the filings are completed and reviewed by the City, the Financial Advisor will submit any reports on the City's behalf to the EMMA system in a timely manner and will provide receipts of the submission to the City.

- VI. Management of Bond Proceeds - When bonds are issued, the proceeds are deposited in various accounts, which may include a construction fund, debt service fund, and an escrow fund in a refunding. Monies allocated to these funds are invested until needed. The investment strategy for each fund will depend, in part, on federal and state statutes and regulations governing the types of instruments permitted to be used, the yield permitted for the fund, and the anticipated drawdown of bond proceeds. Investment of bond proceeds shall be in accordance with the Public Funds Investment Act (PFIA) (Texas Government Code 2256), the Public Funds Collateral Act (Texas Government Code 2257), federal and state laws, and Policy CDA Local according to the cash flow schedule for capital projects. The City's Financial Advisor may not bid on investment products.

The City will incur within six months of the date on which proceeds are issued, a binding obligation to a third party to expend at least five percent of the sale proceeds of the Bonds on a Bond Project. The City reasonably expects that work on or acquisition of the Project will proceed with due diligence to completion and that the proceeds of the Bonds will be expended on the Project within reasonable dispatch. The City reasonably expects that 85

percent of the sale Proceeds of the Bonds will have been expended on the Project prior to the date that is three years after the Issue Date. Any Sale Proceeds not expended prior to the date that is three years after the Issue Date will be either invested at a yield not "materially higher" or make yield restriction payments not less often than every fifth anniversary date of the delivery of the Bonds and within 60 days following the final maturity of the Bonds.

VII. Management of Debt Service Fund - The City has created or continued a debt service fund (the "Debt Service Fund") and the proceeds from all taxes levied, assessed, and collected for and on account of bonds are to be deposited in such Fund. The City expects that taxes levied, assessed and collected for and on account of bonds will be sufficient each year to pay such debt service. The Bona Fide Portion of the Debt Service Fund will be used primarily to achieve a proper matching of revenues and principal and interest payments on bonds within each bond year. Amounts held in the Bona Fide Portion of the Debt Service Fund will be invested at an unrestricted yield because such amounts will be expended within 13 months of the date such amounts are received. The remaining portion of the Debt Service Fund (the "Reserve Portion") will be included in the calculation of arbitrage rebate.

A. Interest Earnings - Interest earnings in the Construction Fund may be used for project costs, principal and interest costs and related fees. Earnings of the Debt Service Fund will be used to pay only principal, interest costs, and related fees on current and future debt.

B. Unreserved, Undesignated Fund Balance - The City will target a minimum debt service fund balance of 25% of the annual debt service requirements on all outstanding debt issuance.

VIII. Compliance

A. Compliance with Statutory Regulations - The City will comply with all statutory regulations in the issuance and structuring of debt obligations.

B. Federal Arbitrage and Rebate Compliance - The City will follow a policy of full compliance with all arbitrage rebate requirements of the Internal Revenue Code of 1986, as amended, and its adopted rules and regulations, and will perform (via contract consultant) arbitrage calculations for each debt issue subject to rebate on an annual basis. All necessary rebates liability will be filed and paid when due.

C. Continuing Disclosure - The City will comply with the continuing disclosure requirements as found in SEC Rule 15c2-12, as amended, to annually disclose certain operating data as well as audited financial statements. Also in accordance with this Rule, the City will file Material Events Notices as required.

IX. Reporting to Committee/Council - The City Manager, Finance Director and the City's Financial Advisor will provide summary debt management reports to the Council at a minimum annually or with every bond sale.