November 1, 2017

Brian Walker, Superintendent
South Monterey County Joint Union High School District
800 Broadway Street
King City, CA 93930

Dear Superintendent Walker:

The purpose of this management letter is to present the findings and recommendations of the Fiscal Crisis and Management Assistance Team's (FCMAT) debt review for the South Monterey County Joint Union High School District. The study agreement dated May 11, 2017, stated that FCMAT would perform a third-party debt review of the district's proposed bond extension and determine what, if any, additional information is required. FCMAT contracted with Government Financial Strategies, Inc. to perform the third-party review due to their expertise in this area.

Background

In March 2017, the district's governing board received a presentation titled General Obligation Bond Program Opportunities from Dale Scott and Company (DS&C) (please see the appendix). Also at the March 22, 2017 meeting, the board approved Board Policy (BP) 3470, Debt Issuance and Management, which is required of local educational agencies (LEAs) as of January 1, 2017 per Senate Bill 1029 approved September 12, 2016. It states that LEAs must adopt a local policy regarding proposed debt issuance and the use of such debt. The district's adopted policy appears to be based on California School Board Association's (CSBA's) policy manual without editing by the district and so includes CSBA's notes for what should be edited. The district should review this policy for needed edits, and for reference, review FCMAT's January 2017 Fiscal Alert and Sample Debt Management Policy (attached).

The district's last bond election was in 1994 and financed construction of Greenfield High School and remodeling and renovation at King City High School. This measure required and received two-thirds voter approval at a special election held on April 12, 1994, authorizing $17,564,000 of general obligation bonds, which were subsequently sold in two series in 1994 and 1995. Both series were refinanced. The final maturity is August 1, 2020.

In 2016-17, the district's general obligation tax rate was $0.042191 per $100 of assessed value (equal to $42.19 per $100,000 of assessed value), according to the Monterey County auditor-controller's office.

The DS&C presentation proposed submitting a bond measure in 2018 to voters to extend the tax, with an estimated tax levy of $45 per $100,000 of assessed value. Three options were presented:

1. Bonds to be issued in three series, each with a 25-year term, in 2020, 2023, and 2025.

2. Bonds to be issued in six series as a general obligation flex-bonds option, with a four-year term for bonds issued in 2020, and three-year terms for bonds issued in 2024, 2027, 2030, 2033, and 2036.

3. Bonds to be issued in five series, utilizing a hybrid approach to the above two options, with an initial series issued with a 25-year term in 2020, and the remaining series having four-year terms issued in 2024, 2028, 2032, and 2036.

The conclusion of this presentation was that the district could generate more than $43 million in facilities funding using one of these approaches and limiting projected tax levies to $45 per $100,000 of assessed value. All three options would require either two separate 55% voter approval measures at different times or a two-thirds voter approval method, as the $45 tax levy target exceeds the $30 limit on projected tax levies for a 55% voter approval measure (Education Code Section 15268).

Based on conversations with the district, FCMAT's understanding is that the district plans to conduct a competitive request for proposals (RFP) process for each of the following services: facility needs assessment and/or facility master plan, independent financial advisory services and bond counsel services, and as needed, competitive bidding or RFP for other consultants/vendors: state school construction funding consultant, public opinion survey firm, bank/lender/bond underwriter, etc.

Although the district no longer plans to pursue the options as presented by DS&C, FCMAT's scope of work was to review the DS&C information presented to the board and to help the district understand how to evaluate a proposed plan for submitting a bond measure to voters in terms of feasibility and affordability.

This report reviews the DS&C presentation based on key questions that relate to a proposed general obligation bond measure, its affordability, and potential risks.

Questions Addressed

Why is the district considering a new general obligation bond measure?

The district has not made major capital investments since those of the 1994 measure, nor does it have a current formal facility needs analysis, even though staff believe there are many worthwhile facilities projects that could be done if a new local bond measure was approved that could provide millions of dollars of capital investment and could generate additional state matching funds.

The DS&C presentation shows the minimum time over which the $43 million would be available is 2020 through 2025, and the maximum is 2020 through 2036, depending on the option selected, and the most that would be available in 2020 under any option is just over $15 million. Based on conversations with the district, FCMAT's understanding is that the district plans to conduct a competitive RFP for a facility needs assessment and/or facility master plan, as well as solicit RFPs for other independent services, such as financial advisors, bond counsel, and other consultants/vendors when needed such as state school construction funding consultants, public opinion survey firms, and bank/lender/bond underwriters. Conducting an RFP process to obtain external professional help with determining facilities needs and costs is critical and should be carefully considered in light of the available funds as well as the cost of inflation, as a significant amount of the bond proceeds would not be available for more than five years.

What will the annual bond obligation be, including debt service payments and administrative costs?

The annual obligation consists of two components: debt service and ongoing administrative costs.

Debt Service

Taxpayers would pay the debt service obligation. Materials provided by DS&C did not separate principal and interest components for the three options, though each option is based on a $45 tax levy.

Three graphics in the March 2017 presentation by DS&C show the estimated debt service for Options 1, 2 and 3 (see attached appendix, pages 6, 7 and 8). All three options focused on debt service structuring approaches that would maintain a $45 tax levy projection and would provide widely varying annual debt service amounts, numbers of series of bonds, and total repayment amounts. Option 1 costs over $83 million to repay $43.8 million in bonds, while Option 2 costs $46.2 million to repay the same amount, and Option 3 costs $54.9 million to repay $43.4 million in bonds.

The presentation also addressed the possibility of dividing the district into two school facilities improvement districts (as described in Education Code Sections 15300-15425, which allows a general obligation bond measure in a portion of a school district where only that portion votes and is taxed). One would be the area coterminous with Greenfield School District and the other would be the remainder of the district. In addition, the presentation included a list of tasks to be accomplished over three months to prepare for a 2018 bond measure and an explanation of what types of costs would be contingent, noncontingent, and payable from bond proceeds or the general fund. No budget information for these costs was included.

Ongoing Bond Administrative Costs

Bond administrative costs generally include continuing disclosure reporting services and paying agent services. While the expected bond administrative costs were not provided in the presentation, DS&C has a contract with the district to provide continuing disclosure services for the district's existing bonds for an annual fee of $5,000. With a new bond measure, the district would have additional continuing disclosure responsibilities. Rather than incurring additional costs, the district should consider learning how to administer continuing disclosures in-house, and review competitive proposals at the time of any additional issuance, as both the necessary work and fees can vary quite a bit, and not commensurately.

The annual cost of paying agent services for the existing bonds is $600. It is unknown whether a new paying agent agreement for additional bonds would be similarly priced.

What is the risk that the annual obligation will vary from year to year and by how much?

All three options are based on a projected $45 tax levy and therefore have significantly varying debt service. Assessed value has been assumed to grow 3% annually. If debt service is as projected, and the assessed value grows at a slower rate, then tax levies will be above projections; conversely, if the growth rate of assessed value exceeds 3%, then the tax levies will be below projections. Additionally, Option 1 is structured to have lower debt service in the final two years and Option 3 is structured to have lower debt service in the final five years. Additionally, the analysis provided by DS&C supporting the presentation shows a simplified method of calculating debt service: the total assessed value for each year was multiplied by the assumed tax levy then evenly distributed to outstanding series of bonds. This does not take into account that secured and unsecured assessed value is taxed differently, and that the county utilizes a 5% assumed delinquency rate. Table 1 below demonstrates the variance in debt service between each of the options.

Table 1

	Minimum Debt Service	Fiscal Year	Maximum Debt Service	Fiscal Year
Option 1	$989,525	2019-20	$4,121,404	2046-47
Option 2	$1,007,425	2019-20	$3,189,187	2037-38
Option 3	$1,007,425	2019-20	$3,284,863	2038-39

Per the graphic titled District AV Remains Stable from the DS&C presentation (see page 2 of the attached appendix), historic assessed value for only the portion of the district in Monterey County is presented as an average of 3.0% growth over the past six years and 1.9% for the previous 10 years. (Historically, Monterey County has accounted for over 98% of the district's assessed value.) A review of the analysis provided by DS&C supporting the presentation indicates that a 3% compound annual growth rate was used to project future assessed value.

The DS&C presentation shows average changes based on averaging the annual changes (a calculation that does not seem to correspond to the compound annual growth rate used to project future assessed value). In addition, the five-year average takes into account the past five annual percentage changes, while the 10-year average takes into account the past nine annual percentage changes. These appear to be inconsistent comparisons for the district to base a decision on.

A more detailed analysis prepared as part of this review shows that, including the portion of the district in San Benito County, the more relevant measure of compound annual growth rate (CAGR) over the 10-year period used by DS&C (fiscal year ending June 30, 2017) is 1.86%. While for this 10-year period the difference may seem small (1.9% vs. 1.86%), even small changes make a difference in the resulting tax base, given compounding. Further, as an example of why averaging annual changes is less relevant than the CAGR, especially due to the historical volatility in the district's tax base, the 10-year period ending June 30, 2015, shows a CAGR of 4.10% and an average yearly change of 5.64%, mostly due to a 13.8% increase in the first year. Thus, the better measure of CAGR should be used to justify future CAGR assumptions, and data from a longer period should be considered.

As shown on page 2 of the DS&C District AV Remains Stable graphic, the district has had noticeable tax base volatility in recent years (the slide heading seems in error given the data shown). Therefore, neither a five-year nor a 10-year period provides sufficient history to develop an assumption underlying a projection for assessed value growth over a 32-year period.

Because the proposed bond measure options were specifically designed to maintain the $45 projected tax levy, the projected assessed value is a key factor. Once each series of bonds is issued and the debt service set, the county will determine tax rates as needed to pay debt service based on the then-current tax base. Because tax base growth is cumulative, the tax base growth assumption(s) are crucial. If tax base growth is projected at 3% every year, and the tax base growth ends up being less, even for just a year or two, the tax levy would rise above $45.

Another point to consider is that each of the three options requires several series of bonds as listed in Table 2.

Table 2

	No. of Series	Final Year Bonds to be Issued
Option 1	3	2025
Option 2	6	2036
Option 3	5	2036

Because so many of the bonds will be not be issued for several years, all three options contain significant risk that if the cumulative assessed value growth rate of 3% is not met or exceeded, bonds will not be able to be issued on schedule, if ever.

What are the projected tax rates?

The debt service on the bonds will be paid from ad valorem property taxes levied by the counties of Monterey and San Benito. The DS&C analysis was based on a mostly level (and maximum) projected tax levy of $45.

What is the likelihood the projected taxes will be sufficient?

The 1.86% CAGR for the prior 10-year period indicates that the assumed 3% annual growth rate may be too aggressive. There is reasonable likelihood that tax levies could exceed the projected maximum and that the district may not be able to issue all the bonds, posing a dual risk: taxes above the projected limit and an inability to provide expected facilities projects. Even if all bonds can eventually be issued, because facilities projects costs are subject to inflation and the bond authorization is a fixed amount, delays to the bond issuance schedule usually result in less purchasing power and result in an inability to deliver expected facilities projects.

What is the cost of funds and are they reasonable?

It is important to analyze the cost of funds because lower costs produce more funds for projects. The cost of funds includes costs of issuance and interest costs.

Costs of Issuance and Underwriter's Discount

The DS&C analysis indicates that the projected costs of issuance (which includes bond counsel fees and expenses, financial advisor fees and expenses, rating fee, etc.) for each series of bonds is $200,000. Based on a review of comparable transactions, FCMAT would expect issuance costs to be in the range of $150,000 to $200,000, so this is a reasonable estimate.

The underwriter's discount used in the analysis is 0.5% of the borrowing amount for each series, which is also considered reasonable based on a review of other comparable transactions.

Interest Costs

For Option 1, the assumed interest rates are 4.5% for the 2020 series, 5.0% for the 2023 series, and 5.5% for the 2025 series.

For Option 2, the assumed interest rate for all six series is 2.5%.

For Option 3, the assumed interest rates are 4.5% for the 2020 series and 2.5% for the remaining four series.

For reference, the Bond Buyer 20-Year Municipal General Obligation Bond Index (Bond Buyer Index) as of March 16, 2017 (the last stated value prior to the March 22, 2017 presentation) was 4.02%. The Bond Buyer Index is information about current market conditions, and for a specific credit rating higher than the district's (whose current credit rating is "A" as reported by Standard and Poor's on December 5, 2016) for a 20-year maturity, as opposed to the different maturities included for the district as an option. The series with three- and four-year terms were assumed to be at a lower rate, presumably due to the short terms.

In developing a plan for the issuance of bonds in the future, the risk and magnitude of the effect of worsening market conditions should be considered, as well as the specific credit of the district and the varying maturities of the bonds to be issued. The general obligation flex bonds (Option 2) and hybrid structure (Option 3) both have a final series of bonds to be issued in 2036, or 16 years after the first series is issued, representing significant risk of market volatility. For example, 16 years prior to the presentation, March 15, 2001, the Bond Buyer Index was 5.11%, as compared to the 4.02% Bond Buyer Index described above as relevant at the time of the March 22, 2017 presentation.

Additional Comments

For a 55% bond measure the maximum projected tax levy is $30, so for the projected tax levy to be $45, either two separate measures would need to be passed or the district would need to consider a two-thirds measure.

There is no current facility needs assessment or facility master plan that can be used to determine the amount of facility needs, and the district's interest in having one will be important in considering a bond measure. However, the potential funding from a bond measure in the near term (five years) based on the DS&C presentation is much less than $43 million, and thus a facility master plan would be judicious in matching potential revenues and expenditures.

There have been discussions in the district regarding the potential unification of Greenfield Union School District with the Greenfield High School District attendance area. There are numerous implications of the discussed unification for a potential bond measure put forward by the district (both before and after voter approval). FCMAT's understanding is that this unification is not currently proceeding, and thus the district does not see a reason to consider these implications.

Conclusion

It has been more than 20 years since the district's facilities have received significant capital investment. Since the needs have not been clearly defined with cost estimates, FCMAT concurs that the district should conduct an RFP for a facility needs assessment and/or a facility master plan. This RFP could include identification of potential state funds that could be obtained by the district, or a separate RFP could be sent to state school construction funding consultants to do so. It is important for all facilities, just as all potential revenues, to be taken into consideration.

It is suggested that the district utilize the Government Finance Officers Association's (GFOA) recommended Best Practice for Selecting and Managing Municipal Advisors by conducting an RFP for independent financial advisor services. Beyond the stated GFOA criteria, it is further recommended that the district request proposals to include details and justifications regarding any assumptions used.

Additionally, the district could consider separate competitive bidding or RFPs for all professionals to be involved in a potential bond measure, e.g., bond counsel, public opinion survey firm, etc. rather than using a packaged or combined approach. By doing so, the district can better understand and consider what each specific consultant is doing and at what cost. A review of the six attached GFOA references will assist the district in developing a bond plan and a procurement process for external assistance and avoid packaged approaches that may not be suitable or the best option.

While FCMAT understands that the district is no longer considering moving ahead with the options proposed last March for submitting a bond measure or measures to the electorate, this analysis is meant to demonstrate how dependent a bond program is on detailed assumptions and conclusions made by the district's financial professionals. Detailed scrutiny as well as comparative information will help the district gain a risk-managed approach in which promised results are more likely in the future. Additional GFOA Best Practices are attached to assist the district in this endeavor, and more can be found at http://www.gfoa.org/best-practices.

Attachments:

DS&C March 22, 2017 Presentation
FCMAT Fiscal Alert - Increased Requirements for Debt Management Policy and Practices
FCMAT Sample Debt Management Policy
GFOA Best Practice - Selecting and Managing Municipal Advisors
GFOA Checklist - Small Government/New Issuer-Debt Issuance Checklist: Considerations When Issuing Bonds
GFOA Best Practice - Selecting Bond Counsel
GFOA Best Practice - Selecting and Managing the Method of Sale of Bonds
GFOA Best Practice - Debt Issuance Transaction Costs
GFOA Best Practice - Debt Management Policy

FCMAT would like to thank the staff of the South Monterey County Joint Union High School District for their cooperation and assistance during the fieldwork.

Sincerely,

Michelle Giacomini

Michelle Giacomini
Chief Management Analyst

ATTACHMENTS

March 22, 2017

South Monterey County Joint Union HSD

General Obligation Bond Program Opportunities

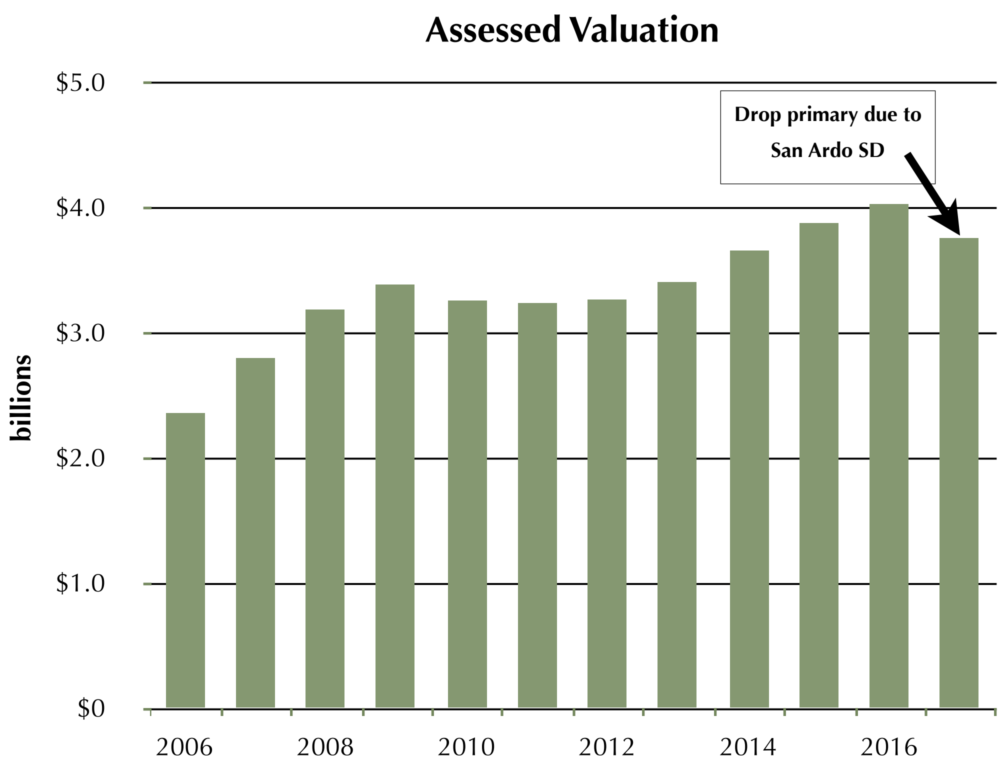
Prepared by:

DS&C

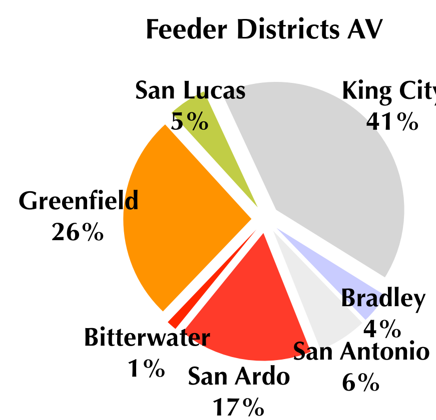
650 California Street, 8th Floor
San Francisco, California 94108
415/956-1030
www.dalescott.com

South Monterey County Joint Union HSD: Assessed Valuation

District AV Remains Stable



Assessed Valuation: 2006 to Date		
FY ending	(billions)	% change
2008	$3.19	
2009	$3.39	6.3%
2010	$3.26	-3.8%
2011	$3.24	-0.6%
2012	$3.27	0.9%
2013	$3.41	4.3%
2014	$3.66	7.3%
2015	$3.88	6.0%
2016	$4.03	3.9%
2017	$3.76	-6.7%
5 Year Average		3.0%
10 Year Average		1.9%



Source: Monterey County Tax Rate Book (Does not include San Benito County portion)

South Monterey County Joint Union HSD: **Bond History**

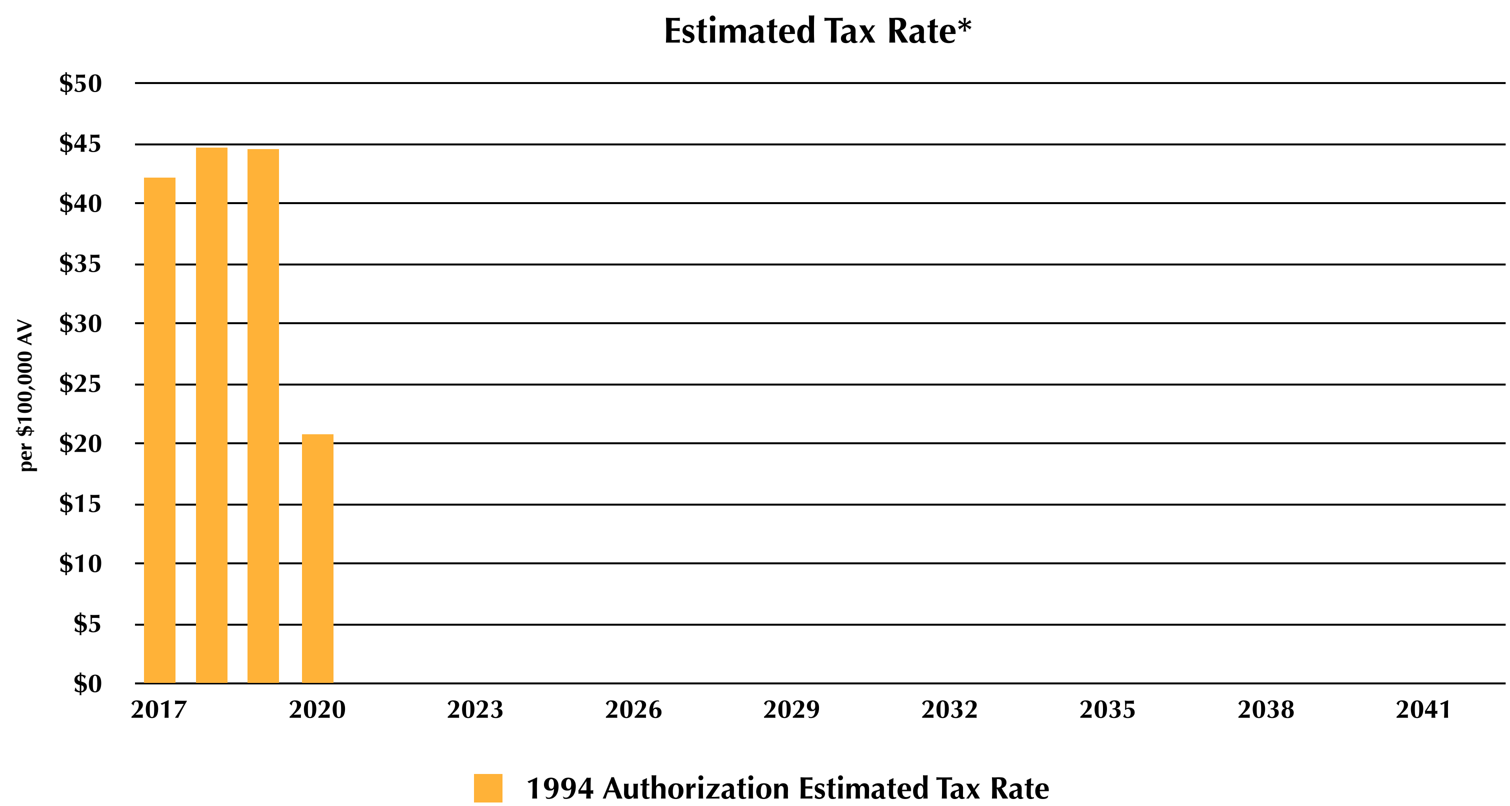
District Voters Approved $17.6 million G.O. Bond in 1994

Total Authorizations				
Date	**Amount**	**% of Approval**	**Type**	**Authorized but Unissued**
04/1994	$17,564,000	67.5%	Two-Thirds	$0

Outstanding Total Debt Service				
	Year	**Principal**	**Interest**	**Total**
2012 REF	2012	$11,820,000	$1,847,317	**$13,667,317**

South Monterey County Joint Union HSD: **Total Tax Rate**

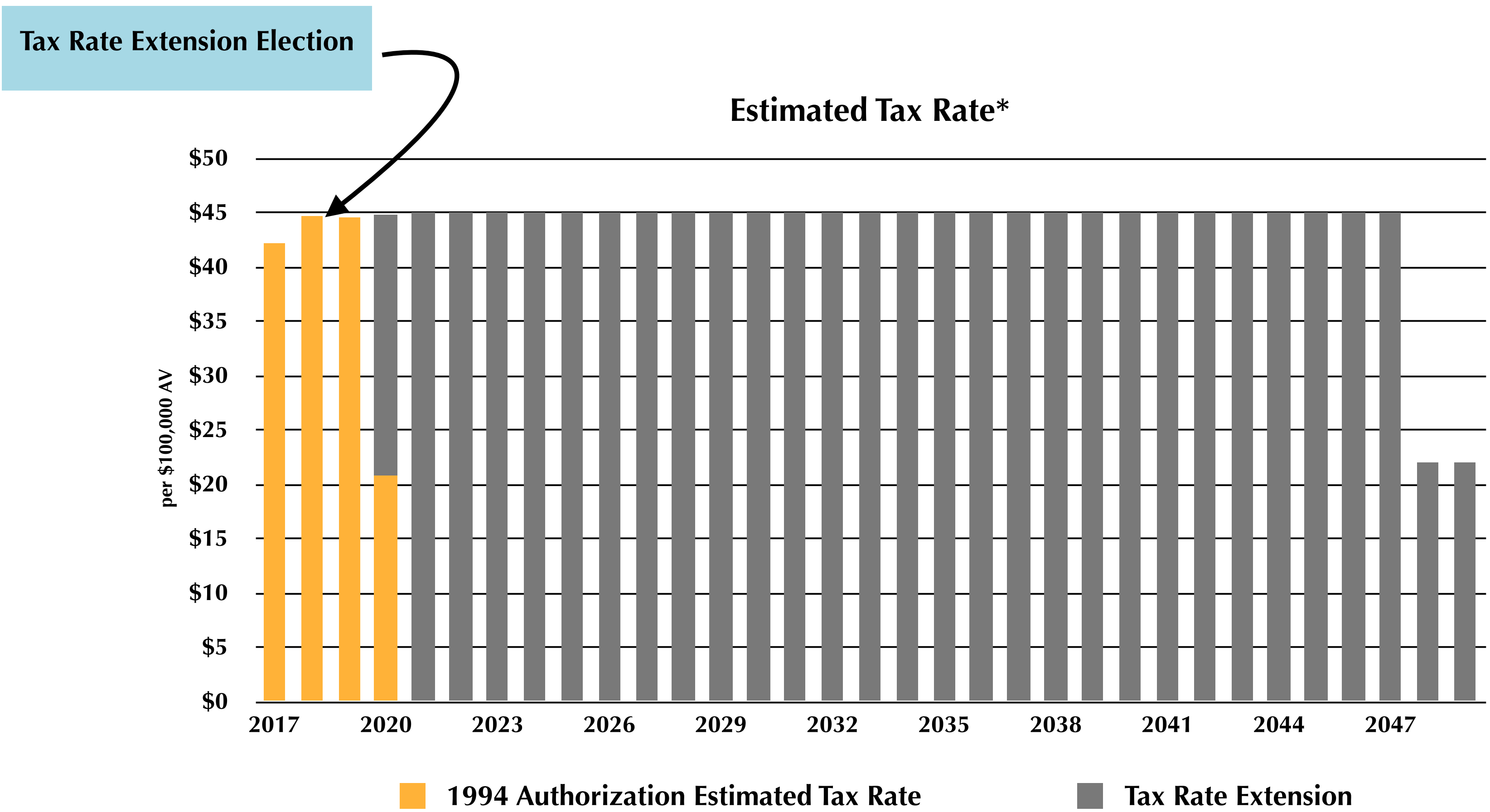
1994 Authorization Repayment Expires in 2020



* Assumes 3.0% AV growth rate

South Monterey County Joint Union HSD: **Tax Rate Extension**

Tax Rate Extension Produces $43+ Million in Funding Without Raising Taxes

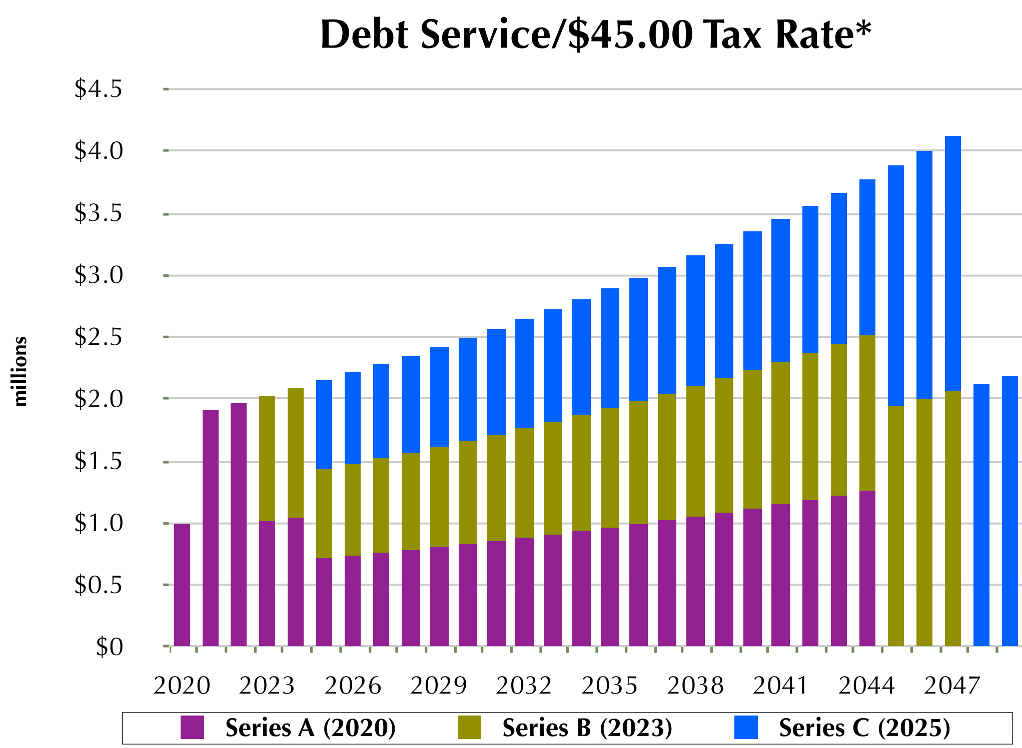


* Assumes 3.0% AV growth rate

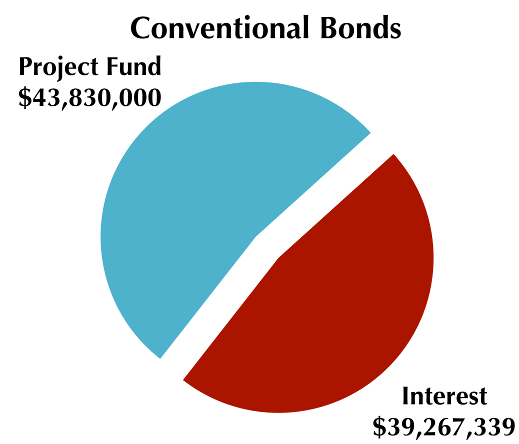
DS&C

South Monterey County Joint Union HSD: Debt Review

Conventional Bonds Require Taxpayer Payments for 25+ Years



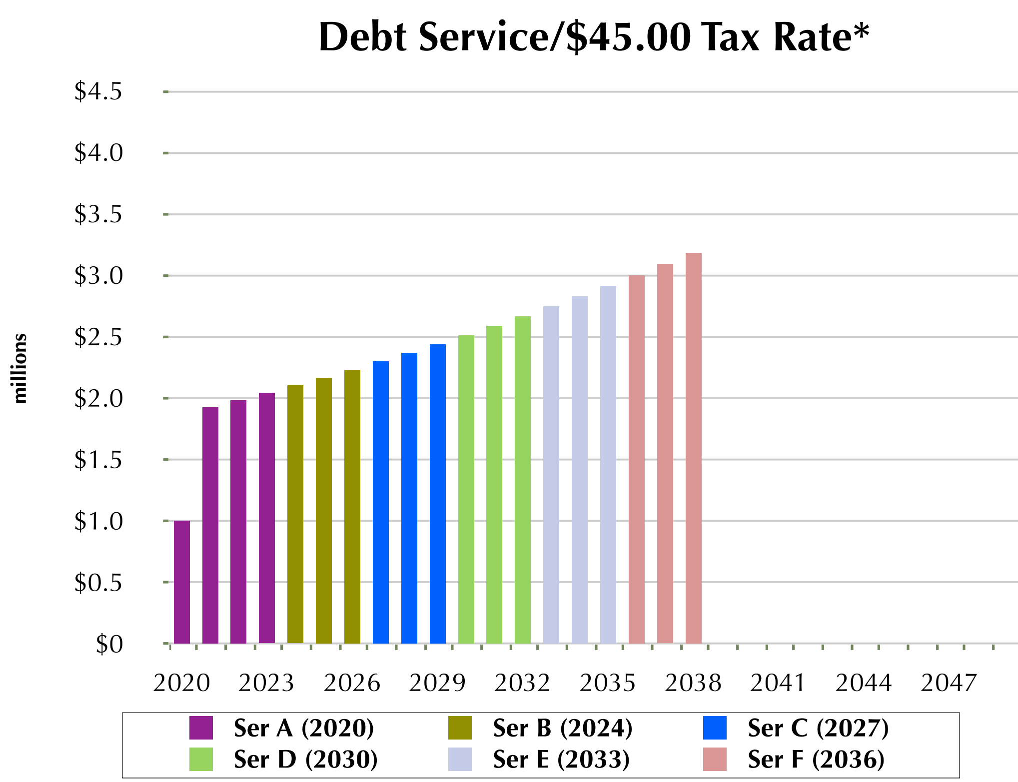
Alternative A: Conventional			
Year	**Principal**	**Interest**	**Total**
2020	$15,740,000	$10,452,303	**$26,192,303**
2023	$14,155,000	$13,172,092	**$27,327,092**
2025	$13,935,000	$15,642,944	**$29,577,944**
Total	**$43,830,000**	**$39,267,339**	**$83,097,339**



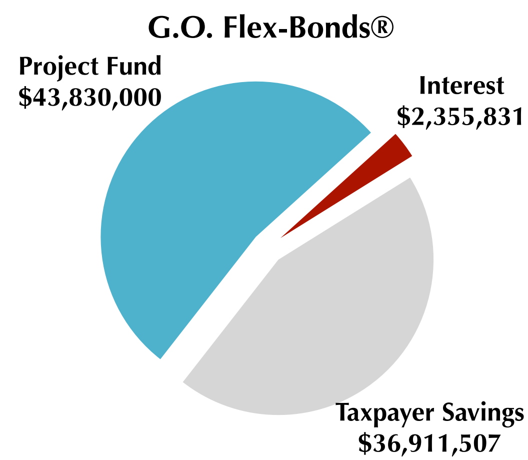
* Assumes 3.0% AV growth rate, 4.5%, 5.0%, and 5.5% interest rates for Series A, B & C respectively
Would require either two Prop 39 (55%) elections or a two-thirds election

South Monterey County Joint Union HSD: **Debt Review**

G.O. Flex-Bonds® Reduce Interest Costs



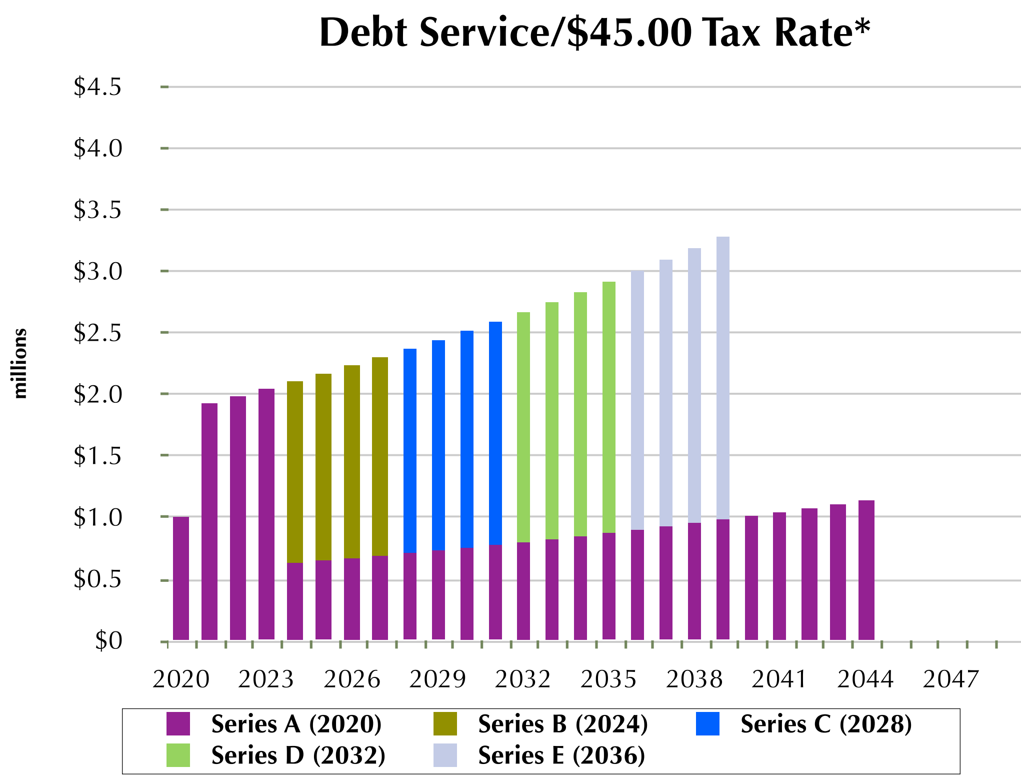
Alternative B: G.O. Flex-Bonds ®			
Year	**Principal**	**Interest**	**Total**
2020	$6,520,000	$451,350	**$6,971,350**
2024	$6,200,000	$316,942	**$6,516,942**
2027	$6,775,000	$346,238	**$7,121,238**
2030	$7,405,000	$376,569	**$7,781,569**
2033	$8,090,000	$413,131	**$8,503,131**
2036	$8,840,000	$451,601	**$9,291,601**
Total	**$43,830,000**	**$2,355,831**	**$46,185,831**



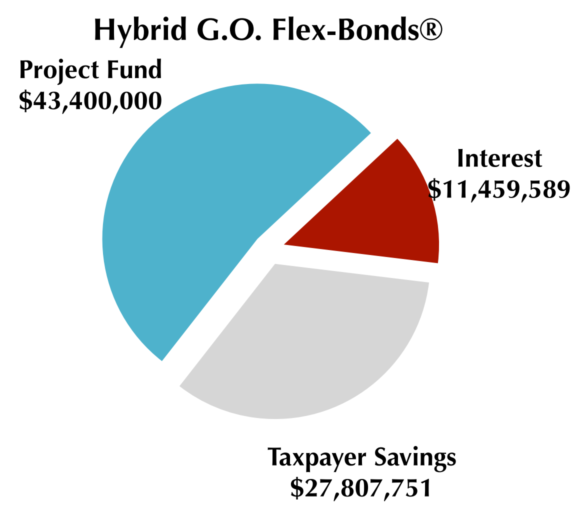
* Assumes 3.0% AV growth rate, 2.5% interest rate
Would require either two Prop 39 (55%) elections or a two-thirds election

South Monterey County Joint Union HSD: Debt Review

Hybrid Structure Meets District Needs While Protecting Taxpayers



Alternative C: Hybrid G.O. Flex-Bonds ®			
Year	**Principal**	**Interest**	**Total**
2020	$15,450,000	$9,660,047	**$25,110,047**
2024	$5,800,000	$374,615	**$6,174,615**
2028	$6,530,000	$419,584	**$6,949,584**
2032	$7,350,000	$471,818	**$7,821,818**
2036	$8,270,000	$533,525	**$8,803,525**
Total	**$43,400,000**	**$11,459,589**	**$54,859,589**

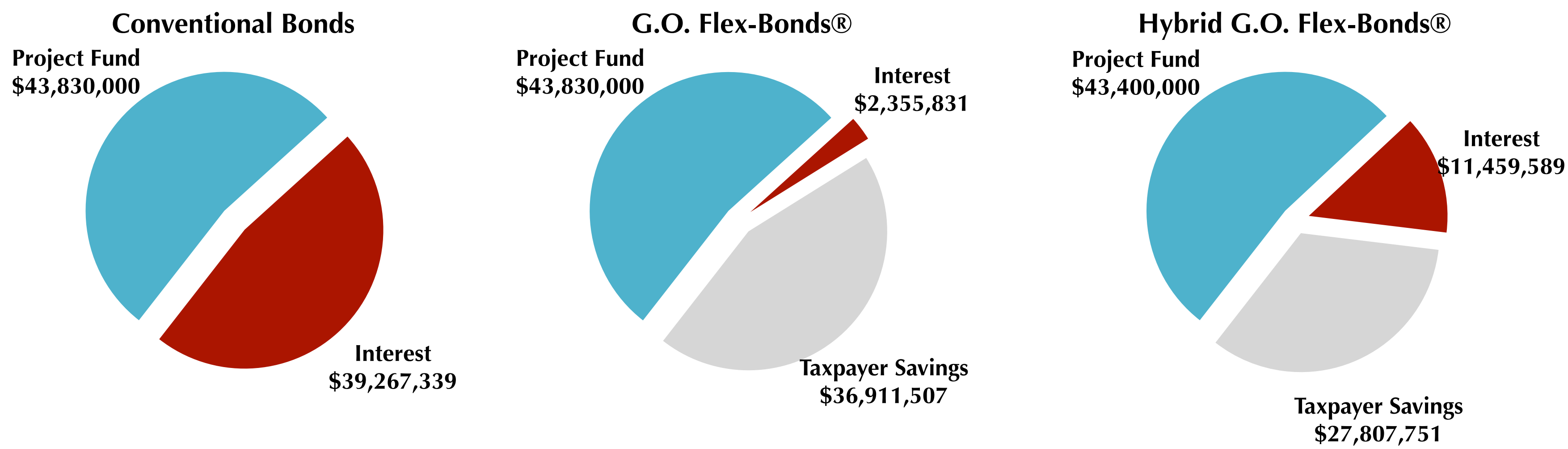


* Assumes 3.0% AV growth rate, 4.5% interest rate (Series A), 2.5% (All Others)
Would require either two Prop 39 (55%) elections or a two-thirds election

South Monterey County Joint Union HSD: **Debt Review**

Benefits of G.O. Flex-Bonds®

Benefit	Comment
Taxpayer Savings:	Total interest costs reduced by 60% to 90%
Replenishable Source of Funding:	Ongoing source of funding for facility improvements
Available for Technology:	Financing term matches useful life of equipment
Prudent Use of Taxpayer Dollars:	Payments go to fund projects, not pay interest
Greater Board Control:	Gives future boards greater control and oversight of District debt structure

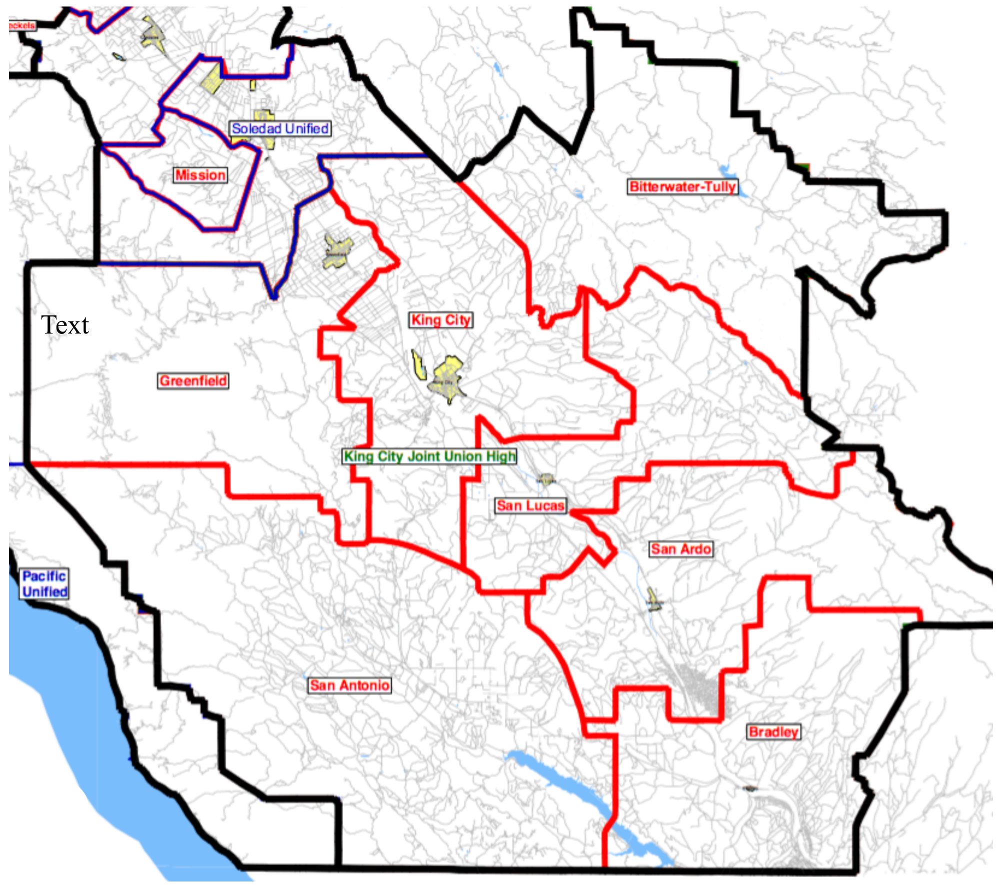


South Monterey County Joint Union HSD: SFID

School Facilities Improvement Districts Allows for Separate Bond Areas within a District

SFID Examples	
District	**County**
Chula Vista ESD	San Diego
Coast USD	San Luis Obispo
Sequoias CCD	Tulare
Gonzales USD	Monterey
Kern CCD	Kern
West Hills CCD	Fresno

South Monterey County JUHSD Tax Rate Extension			
	16-'17 AV (millions)	**% Breakdown**	**Bond Amt. (millions)**
South Monterey less Greenfield SD	$2,814.75	74%	$32.4
Greenfield SD	$994.91	26%	$11.4
Total	**$3,809.66**	**100%**	**$43.8**



South Monterey County Joint Union HSD: Election Costs

Costs Divided Between Pre- and Post-Election

Pre and Post Bond Election Costs				
	Non-Contingent	Contingent on Passage	Payable from General Fund	Payable from Bond
PRE-ELECTION:				
Voter Survey		√	√	
Financial Advisory		√	√	
Legal		√	√	
Misc.		√	√	
Mapping (SFID only)	√		√	
County Election Costs	√			√
Voter Communications (not required)	√		√	
POST-ELECTION:				
Financial Advisory		√		√
Legal		√		√
Rating		√		√
Underwriting		√		√
Misc.		√		√

South Monterey County Joint Union HSD: **Next Steps**

Preparations Take Roughly Three Months

- ✓ Prepare survey research document and conduct voter survey research
- ✓ Presentation of poll results to Board
- ✓ Draft SFID map **(SFID only)**
- ✓ Board adopts resolution of intention to form SFID **(SFID only)**
- ✓ Finalize SFID Map. Publish notice of intent to form SFID **(SFID only)**
- ✓ Discussions with taxpayers groups and community members
- ✓ Publish second notice of intent to form SFID **(SFID only)**
- ✓ Finalize bond size, project list, ballot language, etc.
- ✓ Public hearing/ Board action to create SFID **(SFID only)**

FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

Fiscal Alert
January 2017

Increased Requirements for Debt Management Policy and Practices

Background

Some local educational agencies (LEAs) have adopted debt management policies to provide guidelines for issuing general obligation bonds, certificates of participation (COPs) and other forms of indebtedness. FCMAT has provided a sample debt management policy for several years.

Government Code 8855(i) requires any issuer of public debt to provide a *Report of Proposed Debt Issuance* to the California Debt Investment and Advisory Commission no later than 30 days before the sale of such debt.

New Requirements

Effective January 1, 2017 (per Senate Bill 1029 approved September 12, 2016), the *Report of Proposed Debt Issuance* requires certification that the issuer has adopted a local policy regarding the use of debt and that the proposed debt issuance is consistent with the policy. The local debt policy must include the following five items:

1. The purposes for which the debt proceeds may be used.
2. The types of debt that may be issued.
3. The debt's relationship to and integration with the issuer's capital improvement program or budget, if applicable.
4. Policy goals related to the issuer's planning goals and objectives.
5. The internal control procedures that the issuer has implemented or will implement to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

In addition, Senate Bill (SB) 1029 states:

> The Legislature hereby finds and declares all of the following:
>
> . . .
>
> State and local agencies should adopt comprehensive written debt management policies pursuant to the recommendation of the Government Finance Officers Association, a professional organization of over 18,000 public officials united to enhance

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> and promote the professional management of governmental financial resources. These policies should reflect local, state, and federal laws and regulations.

FCMAT has updated its *Sample Debt Management Policy* to conform to the requirements of both SB 1029 and the Government Finance Officers Association's published best practice on debt management policy (see http://www.gfoa.org/debt-management-policy).

Local educational agencies may want to review existing policies in the 3000, 7000 and 9000 series for existing references to debt or bonds that might be removed in light of adoption of a single comprehensive policy.

Additional Assistance

For additional assistance, LEAs should contact their respective oversight agencies. LEAs may also visit FCMAT's website at www.fcmat.org and submit an online request for assistance.

Sample Debt Management Policy

BP 3461 Business and Noninstructional Operations

Debt Management Policy

Purpose

The district recognizes that the foundation of a well-managed debt program is a comprehensive debt policy that guides the issuance of debt, management of the debt portfolio, and adherence to relevant laws and regulations.

The purpose of this policy is to improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning.

This debt policy sets forth comprehensive guidelines for financing capital expenditures, as well as for addressing short-term cash flow needs. The objectives of this policy are that:

1. The district obtain financing only when necessary.
2. The district use any type of debt financing allowed by California law (e.g., general obligation bonds, revenue bonds, special tax bonds, certificates of participation, lease-purchase financings, tax and revenue anticipation notes, temporary transfers from the county treasury or county superintendent of schools, bond anticipation notes), so long as the financing meets the standards for appropriateness and efficiency described below.
3. The district use a process for identifying the most appropriate and efficient timing, amount and structure of debt.

   Factors to consider when determining the appropriateness of debt are to include the following:

   - Why debt rather than cash expenditure is appropriate.
   - Annual debt service and debt administration costs.
   - The district's financial condition.
   - The district's tax base.
   - Repayment source, including the amount available and its reliability.
   - Legal constraints resulting from the debt (e.g., prepayment terms, reporting requirements).
   - Additional future capital needs.
   - Type of debt instrument.

   Factors to consider when determining efficiency are to include the following:

   - Up-front cost plus long-term costs.
   - Future flexibility.
4. The district operate with extreme caution, and thoroughly investigate all possible conflicts of interest.
5. The district ensure that any required initial and periodic reporting to investors, credit rating agencies, trustees, federal and state agencies, and the county superintendent of schools is timely and accurate.

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CSIS California School Information Services

The governing board will review this policy at least annually and update it as needed. Such a review will include a review of the then-current Government Finance Officers Association's (GFOA's) best practices on debt management policy.

Short-Term Operating Debt Policy

The expenditures associated with the district's day-to-day operations will be covered by current revenues. However, the district may experience temporary cash shortages because it does not receive its revenues in equal installments each month, yet the largest operating expenditures occur regularly in equal amounts. To finance these temporary cash shortfalls, the district may incur short-term operating debt, typically in the form of temporary transfers from the county treasury or county superintendent of schools, or tax and revenue anticipation notes (TRANS). The district will base the amount of the short-term operating debt on cash flow projections for the fiscal year and will comply with applicable federal and state regulations. The district will pledge operating revenues to repay the short-term debt in one year or less. The district will minimize the cost of the short-term borrowing to the greatest extent possible. As allowed by Education Code Section 42603, the district should first consider using interfund transfers before pursuing external borrowing.

Long-Term Capital Debt Policy

The following will apply to the issuance of long-term debt:

1. The district will not use long-term obligations for operating purposes.
2. The term of the long-term obligations will not exceed the useful life of the projects financed.
3. The district will strive to minimize increases in debt service from year to year.
4. When any long-term debt is issued, the governing board will make findings as to the repayment source(s) and the sufficiency of the repayment source(s) until the debt is fully repaid.

Internal Interim Financing

When sufficient funds are available, per Education Code section 42603,the district will consider appropriating them to provide interim financing until long-term financing can be completed, usually within the fiscal year. When the long-term debt obligation is subsequently issued, the funds will be repaid. Use of this strategy requires specific advance notification to the governing board.

Responsibilities of the Chief Business Official

The chief business official will have the primary responsibility for developing financing recommendations and ensuring implementation of the debt policy.

1. The chief business official will review the operating cash flow monthly to determine the need for internal borrowing to maintain progress on the capital improvement program.
2. The chief business official will review the district's capital improvement program at least annually, including the need for financing to maintain the progress on the capital improvement program. This review will be presented to the school board annually. Best practice is to do so in documented form either as part of the adopted budget or in the district's *Management, Discussion and Analysis* prepared for the annual audit report.
3. Because issuing debt is a periodic endeavor and the capital markets constantly change, at least 30 days prior to consideration of any financing the chief business official will review all current GFOA best practices, advisories and guidance documents (found at GFOA.org) and identify to the governing board those relevant to the current capital improvement program and/or operating cash flow needs. This will be done before any governing board action item on the topic of financing.

4. The chief business official will supervise all details of financing endeavors, including a careful review of the documents (e.g., contracts, resolutions, agreements, financial tables).
5. The chief business official will administer the investment of debt proceeds, with the advice of the county treasurer.
6. The chief business official will oversee the expenditure of the debt proceeds and ensure that the debt payments are made on time.
7. The chief business official will ensure that any initial and periodic reporting needed — such as to investors, credit rating agencies, trustees, federal (e.g., the Internal Revenue Service, the Securities and Exchange Commission) and state agencies (e.g., the California Debt and Investment Advisory Commission), and the county superintendent of schools — is timely and accurate.
8. Before any financing is submitted to the governing board for approval, the chief business official will take into consideration the district's internal control procedures, and consult with the district's external auditor regarding fiscal controls needed to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

Engagement of Professionals

This policy recognizes that public finance professionals (e.g., financial advisors, bond counsels, brokers/dealers, and other consultants) market their services extensively. Furthermore, per Public Contract Codes 20110–20118.4, such services are usually exempt from public bidding. To ensure that the district receives appropriate services at a fair price, and to avoid the appearance of conflict of interest, extra caution will be taken when engaging the services of public finance professionals.

Before seeking or considering contracts with public finance professionals, the chief business official will review the then-current GFOA best practices on the following topics:

- Selecting and Managing Municipal Advisors
- Selecting and Managing the Method of Sale of Municipal Bonds
- Selecting Bond Counsel
- Selecting and Managing Underwriters for Negotiated Bond Sales
- Issuer's Role in Selection of Bond Counsel

The chief business official (and the district's purchasing agent) will report to the governing board on a recommended process for determining which professionals are needed, how they will be identified (e.g., request for proposal, or bid), and how their contracts will be developed before being submitted to the governing board for approval. Emphasis will be placed on competition, openness, clarity, and avoiding conflicts of interest. The process recommended may be for a period of time, or for a particular financing or set of financings.

All engagement letters, contracts, disclosures and opinions will be provided to the governing board promptly, and district staff will not sign any such documents without prior notification to the governing board.

References

California Codes:

Education Codes 15140–15150 — Issuance and Sale of Bonds

Education Codes 41000–41003.3 — Moneys Received by School Districts

Education Codes 41010–41023 — Accounting Regulations, Budget Controls and Audits

Senate Bill 1029 — approved by the governor on September 12, 2016; amends Government Code 8855

Government Codes 16430–16495.5 — Investments

Government Codes 53600–53610 — Investment of Surplus

Probate Codes 16045–16054 — Uniform Prudent Investor Act

Public Contracts Code 20110–20118.4 — School Districts

Other:

GFOA best practice — Debt Management Policy, dated October 2012 (http://www.gfoa.org/debt-management-policy)

GFOA debt management documents and resources at http://www.gfoa.org/topic-areas/debt-management

Government Finance Officers Association

BEST PRACTICE

Selecting and Managing Municipal Advisors

BACKGROUND:

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of Municipal Bonds
Selecting and Managing Municipal Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

State and local governments engage municipal advisors to assist in the structuring and issuance of bonds whether through a competitive or a negotiated sale process. While governments may hire municipal advisors for other types of financial transactions, such as investments and swaps, this Best Practice is focused on municipal advisors used primarily in conjunction with a bond sale. A municipal advisor represents the issuer in the sale of bonds, and unlike other professionals involved in a bond sale, has an explicit fiduciary duty to the issuer per the DoddFrank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Additionally, with the implementation of the 2010 Dodd-Frank Act, municipal advisors must register with the Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) and meet professional and testing standards. Issuers should be aware that MSRB Rule G-23 prohibits a broker-dealer firm that also provides financial advisory services (in contrast to a non-broker-dealer municipal advisor) from serving as a municipal advisor to the issuer and an underwriter on the same transaction. Finally, it is important for issuers to become familiar with municipal advisor and underwriter responsibilities as discussed in the materials related to the SECs Municipal Advisor Rule. Resources to help issuers become familiar with the Rule are included in the references section of this document.

RECOMMENDATION:

The Government Finance Officers Association (GFOA) recommends that issuers hire a municipal advisor prior to the undertaking of a debt financing unless the issuer has sufficient in-house expertise and access to current bond market information. Issuers should assure themselves that the selected municipal advisor has the necessary expertise to assist the issuer in determining the best type of financing for the government, selecting other finance professionals, planning the bond sale and successfully selling and closing the bonds. While a municipal advisor plays a key role on the financing team, it is important to note that the issuer remains in control of the decision making process necessary for the issuance and sale of the bonds or implementing the financing.

The GFOA recommends that issuers select municipal advisors on the basis of merit using a competitive process and that issuers review those relationships periodically. A competitive process using a request for proposals (RFP) or request for qualifications (RFQ) process as applicable allows the issuer to compare the qualifications of proposers and to select the most qualified firm based on the scope of services and evaluation criteria outlined in the RFP. Standards related to the selection and hiring of municipal advisors should also be included in agovernments debt management policy. The selection and use of municipal advisors may vary depending on the level of municipal market knowledge, expertise, and experience of the issuers staff.

Before starting the RFP process issuers should decide whether the municipal advisor will assist the issuer in determining whether to do a competitive or negotiated sale. Additionally, the issuer should determine if it is seeking one municipal advisor for a specific transaction or a pool of municipal advisors to select from for future transactions. Small governments may be looking to hire a municipal advisor to assist with a single transaction, whereas larger governments may retain a municipal advisor to assist them with a broad scope of work, in addition to possibly creating a pool of advisors to choose from for transactions that the government anticipates doing for a period of time (e.g., 3 years). The RFP then can be carefully written in order to result in the type of relationship desired by the issuer. Additionally, issuers should write the RFP to comply with applicable procurement requirements.

If an issuer is contemplating the possibility of selling bonds through a negotiated sale, the municipal advisor should be retained prior to selecting the underwriter(s). This allows the issuer to have professional services available to advise on the appropriate method of sale, and if a negotiated sale is selected, to prepare the underwriter RFP and assist in the evaluation of the underwriter responses.

No firm should be given an unfair advantage in the RFP process. Procedures should be established for communicating with potential proposers, determining how and over what time period questions will be addressed and determining when contacts with proposers will be restricted.

Due to potential conflicts of interest, the issuer also should enact a policy regarding whether, and under what circumstances, it would permit a firm to serve as an underwriter on one transaction and a municipal advisor on another transaction. Additionally, when an issuer has a municipal advisor and the issuer is considering hiring that advisor to serve as a broker-dealer on a different negotiated bond transaction, the appearance of a conflict may exist.

Furthermore, each government should decide for itself if they choose to use only non-broker-dealer affiliated municipal advisors or municipal advisors affiliated with broker-dealer firms, and incorporate this into their debt management policies.

Request for Proposal Content. The RFP should include at least the following components:

1. The municipal advisor is registered with the SEC and MSRB. Issuers can determine this by visiting the SEC website at https://tts.sec.gov/MATR/index.html and the MSRBs municipal advisor registration page at http://www.msrb.org/msrb1/pqweb/MARegistrants.asp.
2. A clear and concise description of the scope of work, specifying the length of the contract and indicating whether joint proposals with other firms are acceptable.
3. Clarity on whether the issuer reserves the right to select more than one municipal advisor or to form municipal advisory teams.
4. A requirement that all fee structures be presented in a standard format. Issuers also should

ask all proposers to identify which fees are to be proposed on a not-to-exceed basis, describe any conditions attached to their fee proposal, and explicitly state which costs are included in the fee proposal and which costs are to be reimbursed. Any MSRB fees imposed upon municipal advisors should not be passed through to the issuer.

5. A requirement that the proposer provide at least three references from other public-sector clients, preferably from ones that the firm provided similar services to those proposed to be undertaken as the result of the RFP.
6. A description of the objective evaluation and selection criteria and explanation of how proposals will be evaluated.

Requested Proposer Responses. RFPs should request relevant information related to the areas listed below in order to distinguish each firms qualifications and experience, including:

1. Relevant experience of the individuals to be assigned to the issuer, identification of the individual in charge of day-to-day management, and the percentage of time committed for each individual on the account.
2. Relevant experience of the firm with financings of the issuer or comparable issuers and financings of similar size, types and structures, including financings in same state.
3. Discussion of the firms municipal advisory experience necessary to assist issuers with either competitive or negotiated sales.
4. Demonstration of the firms understanding of the issuers financial situation, including ideas on how the issuer should approach financing issues such as bond structures, credit rating strategies and investor marketing strategies.
5. Demonstration of the firms knowledge of local political, economic, legal or other issues that may affect the proposed financing.
6. Discussion of the firms familiarity with GFOAs Best Practices relating to the selling of bonds and the selection of finance professionals.
7. Disclosure of the firms affiliation or relationship with any broker-dealer and whether any personnel of the municipal advisor firm who would provide advice to the issuer were associated with a broker-dealer firm within the two years preceding the RFP.
8. Analytic capability of the firm and assigned individuals and the availability of ongoing training and educational services that could be provided to the issuer.
9. Description of the firms access to sources of current market information to assist in pricing of negotiated sales and information to assist in the issuer in planning and executing competitive sales.
10. Amounts and types of insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.
11. Disclosure of any finders fees, fee splitting, payments to consultants, or other contractual arrangements of the firm that could present a real or perceived conflict of interest.
12. Disclosure of any pending investigation of the firm or enforcement or disciplinary actions taken within the past three years by the SEC, FINRA, MSRB, or other regulatory bodies.

Additional Considerations. Issuers should also consider the following in conducting the municipal advisor selection process:

1. Take steps to maximize the number of respondents by posting the RFP on the governments web site, using mailing lists, media advertising, resources of the GFOA and applicable professional directories.
2. Allow adequate time for firms to develop their responses to the RFP. Two weeks should be appropriate for all but the most complicated RFPs.
3. Establish evaluation procedures and a systematic rating process, conduct interviews with proposers, and undertake reference checks. Where practicable, one individual should check

all references using a standard set of questions to promote consistency. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the selection team.

4. Document and retain the description of how the selection of the municipal advisor was made and the rankings of each firm.
5. Ensure that federal regulations and any state and local regulations, standards or policies related to the disclosure of gifts, political contributions, or other financial arrangements are met.

Basis of Compensation. Fees paid to municipal advisors should be on an hourly or retainer basis, reflecting the nature of the services to the issuer. Generally, municipal advisory fees should not be paid on a contingent basis to remove the potential incentive for the municipal advisor to provide advice that might unnecessarily lead to the issuance of bonds. GFOA recognizes, however, that this may be difficult given the financial constraints of many issuers. In the case of contingent compensation arrangements, issuers should undertake ongoing due diligence to ensure that the financing plan remains appropriate for the issuers needs. Issuers should include a provision in the RFP prohibiting any firm from engaging in activities on behalf of the issuer that produce a direct or indirect financial gain for the municipal advisor, other than the agreed-upon compensation, without the issuers informed consent.

Contract for Municipal Advisory Services. Issuers should have a written contract for municipal advisory services that should detail the scope of services and basis of compensation. As part of the RFP package, the issuer may also include a Form of Contract which incorporates elements and provisions conforming to prevailing law and procurement processes and requires RFP respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract. A final negotiated contract should make clear those services that will be included within the basic municipal advisor fee and any services or reimbursable expenses that might be billed separately. Additionally, the contract should be clear that the municipal advisor will only receive compensation for work specifically authorized by the issuer to avoid incurring expenses for work not authorized by the issuer.

References:

- GFOA Issue Brief: SEC Municipal Advisor Rule
- SEC Municipal Advisor Rule
- SEC MA Rule Frequently Asked Questions
- Best Practices Optimizing Debt Management, Government Finance Review, February 2013
- GFOA Best Practice: Pricing Bonds in a Negotiated Sale
- GFOA Best Practice: Selecting Bond Counsel
- GFOA Best Practice: Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales
- GFOA Best Practice: Selecting and Managing the Method of Sale of State and Local Government Bonds
- MSRB Rule G-23

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Small Government/New Issuer - Debt Issuance Checklist: Considerations When Issuing Bonds

1) Has the issuer retained a municipal advisor (the issuer should determine if they wish to use a municipal advisor that is or is not associated with a municipal broker/dealer firm) and bond counsel to, among other tasks, assist the issuer in determining the most appropriate method of sale: competitive, negotiated, bank qualified, bank loan or private placement? Is the issuer aware of new SEC regulations over municipal advisors, and the changes regarding if and when an underwriter may provide advice to the issuer? Has the issuer discussed the possibilities of using disclosure counsel in addition to bond counsel? (BP – Selecting and Managing the Engagement of Municipal Advisors; BP – Selecting and Managing the Method of Sale of State and Local Government Bonds, BP – Selecting Bond Counsel, GFOA Municipal Advisor Issue Brief)

2) Is the type of debt being considered the most appropriate form for the type of project being financed? For example, if the capital improvement is for a revenue-generating project or system, the use of revenue bonds may be a better financing option than using a portion of the government's limited general obligation bonding capacity. (BP – Debt Management Policy)

3) Does the maturity structure and estimated debt service match the anticipated flow of revenues available for debt service in a manner that will not raise credit concerns and will unduly contribute to a favorable market reception? (BP –Debt Management Policy)

4) For a competitive sale, do the terms and conditions of sale as described in the Notice of Sale allow potential bidders sufficient flexibility to structure the most favorable bid possible? (BP – Selecting and Managing the Method of Sale of State and Local Government Bonds)

5) For a negotiated sale, does the underwriter request for proposals (RFP) request sufficient information to enable the issuer to select the most qualified firm at the best price? Does the RFP process provide a transparent and objective evaluation/ranking of respondents, free of undue political influence? Additionally, does the RFP require the underwriter to provide information on the cost of borrowing for the duration of the bonds, not just the cost of issuance, as well as having the underwriter provide at sale pricing comparables and a post-pricing book showing market conditions at the time of the sale and other sales in the market at the time of the sale? (BP – Selecting and Managing the Method of Sale of State and Local Government Bonds, Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales)

6) Depending on method of sale and applicable state laws, has the issuer, with assistance from its municipal advisor and/or bond counsel, developed a preliminary official statement, official statement or other disclosure documents, and are they being properly distributed?" (BP – Selecting and Managing the Method of Sale of State and Local Government Bonds, BP – Selecting and Managing the Engagement of Municipal Advisors, BP - Selecting Bond Counsel)

7) Does the preliminary official statement and/or other disclosure documents meet or exceed industry standards? (BP – Maintaining an Investor Relations Program, Using Your Web Site for Disclosure, Understanding Your Continuing Disclosure Responsibilities)

8) Has legal counsel been consulted to ensure that all tax and legal requirements been satisfied, including any public notices as directed by state or federal laws?

9) Has the muncipal advisor and/or bond counsel been consulted to ensure that the appropriate level of investor outreach has been conducted? (BP – Maintaining an Investor Relations Program)

10) Have credit ratings been sought for the issue? Has the municipal advisor and/or bond counsel been consulted as to how many different ratings should or need to be obtained for this type of bond issue? Has the municipal advisor and/or bond counsel been consulted about using bond insurance or other credit enhancements for the issue especially if the rating is, or is expected to be A or lower? (BP – Debt Management Policy)

11) Have post issuance compliance policies and procedures been adopted, to ensure compliance and understanding of what is required by the issuer on an ongoing basis? (Post Issuance Compliance Checklist, BP - Debt Management Policy, BP - Understanding Your Continuing Disclosure Responsibilities, BP – Investment of Bond Proceeds)

12) Do the appropriate issuer officials and representatives have an understanding of all the fees that the issuer must pay in conjunction with the bond transaction? Have the municipal advisor and/or other professionals been consulted about these various fees and if they are necessary and appropriate for a financing of this nature, size and complexity? (BP – Expenses Charged by Underwriters in Negotiated Sales, BP – Cost of Issuance Incurred in a Publicly Offered Debt Transaction).

Resources

- GFOA Best Practice, Cost of Issuance in a Publically Offered Debt Transaction (2013)
- GFOA Best Practice, Debt Management Policy (2012)
- GFOA Best Practice, Expenses Charged by Underwriters in Negotiated Sales (2012)
- GFOA Best Practice, Maintaining an Investor Relations Program (2010)
- GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2010)
- GFOA Best Practice, Understanding Your Continuing Disclosure Responsibilities (2010)
- GFOA Best Practice, Using Your Web Site for Disclosure (2010)
- GFOA Best Practice, Selecting and Managing the Engagement of Municipal Advisors (2014)
- GFOA Best Practice, Selecting Bond Counsel (2008)
- GFOA Best Practice, Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales (2014)
- GFOA Best Practice, Investment of Bond Proceeds (2013)
- GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2014)
- GFOA/NABL, Post Issuance Compliance Checklist
- GFOA Issue Brief: SEC Municipal Advisor Rule
- CDIAC Debt Issuance Primer, http://www.treasurer.ca.gov/cdiac/publications/alphabetical.asp#debt_primer

Government Finance Officers Association

BEST PRACTICE

Selecting Bond Counsel

BACKGROUND:

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of Municipal Bonds
Selecting and Managing Municipal Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

An essential member of a governmental issuers bond financing team is bond counsel. Bond counsel renders an opinion on the validity of the bond offering, the security for the offering, and whether and to what extent interest on the bonds is exempt from income and other taxation. The opinion of bond counsel provides assurance both to issuers and to investors who purchase the bonds that all legal and tax requirements relevant to the matters covered by the opinion are met. An issuer should assure itself that its bond counsel has the necessary expertise to provide an opinion that can be relied on and will be able to assist the issuer in completing the transaction in a timely manner.

RECOMMENDATION:

GFOA recommends that issuers select bond counsel on the basis of merit using a competitive process and review those relationships periodically. A competitive process using a request for proposals (RFP) or request for qualifications (RFQ) permits issuers to compare qualifications of firms and select a firm or firms that best meets the needs of their community and the type of financing being undertaken. The RFP or RFQ should clearly describe the scope of services desired, the length of the engagement, evaluation criteria, and the selection process. Issuers should have a clear understanding of their service needs (single transaction, multiple transaction, or establishment of a qualified pool of firms) and develop the RFP/RFQ to meet these needs. Additionally, issuers should carefully develop an RFP that complies with state and local procurement requirements.

A RFP or RFQ should require firms proposing to serve as bond counsel to submit information that permits the issuer to evaluate the following factors, at a minimum:

1. Experience of the firm with financings of the issuer or comparable issuers, and financings of similar size, types and structures, including financings in the same state.
2. In preparing the RFP the issuer should determine whether specialized tax advice beyond normal bond counsel services is required. In those instances, the firms experience in tax matters and the attorneys who practice full time in the area of public finance tax law should be identified in detail. If the firm has no attorneys who specialize in public finance tax law, the response should indicate how the firm intends to provide competent tax advice.

3. Experience of the firm with and its approach to applicable federal securities laws and regulations. In preparing the RFP the issuer should determine whether specialized securities law services beyond normal bond counsel services is required. In those instances, the firms experience in municipal securities law matters and the attorneys who practice full time in the area of municipal securities law should be identified in detail. If the firm has no attorneys who specialize in municipal securities tax law, the response should indicate how the firm intends to provide competent municipal securities law advice.
4. Knowledge and experience of the attorneys that would be assigned to the transaction, particularly the individual with day-to-day responsibility for the issuers account.
5. Ability of the firm and assigned personnel to evaluate legal issues, prepare documents, and complete other tasks of a bond transaction in a timely manner.
6. Relationships or activities that might present a conflict of interest for the issuer.
7. Level of malpractice insurance carried, including the deductible amount, to cover errors and omissions, improper judgments, or negligence.

Individuals in the organization with experience in public finance and/or responsible for debt management activities should be involved in the RFP or RFQ development and response review. This may include representatives from the finance department and internal counsel. To remove any appearance of a conflict of interest resulting from political contributions or other activities, elected officials should not be part of the evaluation and/or selection team. In reviewing and evaluating the RFP or RFQ responses, evaluation procedures and a systematic rating process should be established which consider the following:

1. The use of oral interviews of proposers, in which the attorney who would have day-to-day responsibility for the issuers account should be asked to assume the lead role in presenting the qualifications of the firm.
2. The selection should not be driven solely by proposed fees. The experience of the firm with the type of transactions and the ability to deliver the required legal services in a timely manner are the most important factors in the selection of bond counsel.
3. For issuers that have ongoing needs of a similar nature, continuity should be considered an important factor in the evaluation process.
4. Different fee arrangements are possible depending on the type and nature of the engagement. Fee arrangements include both fixed fee and hourly which may or may not include a cap on the total compensation. Additionally, fees may also be paid contingent on the sale of bonds. Generally bond counsel fees should not be paid on a contingent basis to remove the potential incentive for bond counsel to render legal or tax options that would result in the inappropriate issuance of bonds. However, this may be difficult given the financial constraints of many issuers; in the case of contingent fee arrangements (as well as other fee arrangements), issuers should undertake ongoing due diligence to ensure the bond issue and structure remains appropriate for their organization. Fees and method of compensation (fixed fee, hourly, or retainer) should appropriately reflect the complexity and scope of the services to be provided.
5. Before making a final selection, the issuer should check the references furnished by the prospective bond counsel and determine the outcome of examinations by the IRS or other regulatory agencies of transactions in which the prospective bond counsel was involved. Where practical, one individual should check all references using a standard set of questions to promote consistency.

The issuer may also choose to include a Form of Contract in the RFP or RFQ package, which incorporates elements and provisions conforming to prevailing law and procurement processes. The RFP or RFQ should require respondents to comment on the acceptability of the Form of Contract. The comments on the acceptability of the Form of Contract should be part of the evaluation process. The contract development process should allow for reasonable negotiation over the final terms of the contract and/or engagement letter. A final negotiated contract or the engagement letter should make clear those services that will be included within the basic bond counsel fee and any services or reimbursable expenses that might be considered separately billable. If co-bond counsels are being engaged, the issuer should:

1. delineate in the RFP or RFQ or engagement letter the roles and responsibilities of each firm;
2. assign discrete tasks to each firm in order to minimize cost duplication; and
3. exercise appropriate oversight to ensure coordination of tasks undertaken by the firms.

If co-bond counsels are engaged or if bond counsel firms are rotated, the issuer should:

1. evaluate whether higher costs for legal services will result because of the need for two or more firms to familiarize themselves with the issuer; and
2. consider the possible need to resolve differing viewpoints of each bond counsel.

Throughout the term of the engagement, the performance of bond counsel should be evaluated in relation to the stated scope of services and any areas where service needs to be improved should be communicated to the lead attorney. Ongoing contracts should be reviewed regularly and resubjected to competitive selection periodically.

References:

- GFOA Best Practice, Preparing RFPs to Select Financial Advisors and Underwriters, 1997.
- *A Guide to Selecting Financial Advisors and Underwriters: Writing RFPs and Evaluating Proposals*, Patricia Tigue, GFOA, 1997.
- "Model Engagement Letters," National Association of Bond Lawyers, 1998.
- The Selection and Evaluation of Bond Counsel, National Association of Bond Lawyers, 1998.

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Government Finance Officers Association

BEST PRACTICE

Selecting and Managing the Method of Sale of Bonds

BACKGROUND:

Note: This Best Practice (BP) is one of a group of five relating to the sale of bonds. These five BPs should be read and considered in conjunction with each other because of the interaction of the processes to which they apply. The five BPs are:

Selecting and Managing the Method of Sale of Municipal Bonds
Selecting and Managing the Municipal Advisors
Selecting Bond Counsel
Selecting Underwriters for Negotiated Bond Sales
Pricing Bonds in a Negotiated Sale

State and local government bond issuers should sell their debt using the method of sale that is most likely to achieve the lowest cost of borrowing while taking into account both short-range and long-range implications for taxpayers and ratepayers. Differing views exist among issuers and other bond market participants with respect to the relative merits of the competitive and negotiated methods of sale. Moreover, research into the subject has not led to universally accepted findings as to which method of sale is preferable when taking into account differences in bond structure, security, size, and credit ratings for the wide array of bonds issued by state and local governments.

Concerns have been raised about the lack of a competitive process through the use of Request for Proposals (RFPs) in the selection of underwriters in a negotiated sale and the possibility of higher borrowing costs when underwriters are appointed based on factors other than merit. As a result, issuers have been forced to defend their selection of underwriters for negotiated sales in the absence of a documented, open selection process.

The appropriate duties, roles and responsibilities of municipal advisors and underwriters are often not well understood. Municipal advisors are the only parties with a federal fiduciary duty to state and local government issuers. In contrast, the relationship between the issuer and underwriter is one where the relationship has a common purpose but also some competing objectives, especially at the time of bond pricing. It is important for issuers to become familiar with the Securities and Exchange Commissions (SEC) Municipal Advisor Rule, and understand its implications on underwriter responsibilities as discussed in the materials related to the Municipal Advisor Rule. Resources to help issuers become familiar with the Rule are included in the References section of this document.

RECOMMENDATION:

When state and local laws do not prescribe the method of sale of municipal bonds, the Government Finance Officers Association (GFOA) recommends that issuers select a method of sale based on a thorough analysis of the relevant rating, security, structure and other factors pertaining to the proposed bond issue. If the issuer has in-house expertise, defined as dedicated debt management staff whose responsibilities include daily management of a debt portfolio, this analysis and selection could be made by the issuers staff. However, in the more common situation where an issuer does not have sufficient in-house expertise, this analysis and selection should be undertaken with the advice of a municipal advisor. Due to the inherent conflict of interest, issuers should not use a broker-dealer or potential underwriter to assist in the method of sale selection unless that firm has agreed not to underwrite that transaction. Additionally, Municipal Securities Rulemaking Board (MSRB) Rule G-23 states that a broker-dealer firm may not serve as municipal advisor and underwriter on the same transaction.

The GFOA believes that the presence of the following factors may favor the use of a competitive sale:

1. The rating of the bonds, either credit-enhanced or unenhanced, is at least in the single-A category.
2. The bonds are general obligation bonds or full faith and credit obligations of the issuer or are secured by a strong, known and long-standing revenue stream.
3. The structure of the bonds does not include innovative or new financing features that require extensive explanation to the bond market.
4. The issuer is well known and frequently in the market.

Similarly, GFOA believes that the presence of the following factors may favor the use of a negotiated sale:

1. The rating of the bonds, either credit-enhanced or unenhanced, is lower than single-A category.
2. Bond insurance or other credit enhancement is unavailable or not cost-effective.
3. The structure of the bonds has features such as a pooled bond program, variable rate debt, deferred interest bonds, or other bonds that may be better suited to negotiation.
4. The issuer desires to target underwriting participation to include disadvantaged business enterprises (DBEs) or local firms.
5. Other factors that the issuer, in consultation with its municipal advisor, believes favor the use of a negotiated sale process.

If an issuer, in consultation with its municipal advisor, determines that a negotiated sale is more likely to result in the lowest cost of borrowing, the issuer should undertake the following steps and policies to increase the likelihood of a successful and fully documented negotiated sale process:

1. There should be a written contractual relationship with a municipal advisor (a firm unrelated to the underwriter(s)), to advise the issuer on all aspects of the sale, including selection of the underwriter, structuring, disclosure preparation and bond pricing.
2. Select the underwriter(s) through a formal request for proposals (RFP) process. The issuer should document and make publicly available the criteria and process for underwriter selection so that the decision can be explained, if necessary.
3. Due to potential conflicts of interest, the issuer should also enact a policy regarding whether and under what, if any, circumstances it will permit the use of a single firm to serve as an underwriter on one transaction and a municipal advisor on another transaction.
4. Issuers with sufficient in-house expertise and access to market information may not need to retain a municipal advisor. Such issuers should have at least the following skills and information: (i) access to real-time market information (e.g. Bloomberg) to assess market conditions and proposed bond prices; (ii) experience in the pricing and sale of bonds, including historical pricing data for their own bonds and/or a set of comparable bonds of other issuers in order to assist in determining a fair price for their bonds; and (iii) dedicated

full-time staff to manage the bond issuance process, with the training, expertise and access to debt management tools necessary to successfully negotiate the pricing of their bonds.

5. Remain actively involved in each step of the negotiation and sale processes in accordance with the GFOAs Best Practice, Pricing Bonds in a Negotiated Sale.
6. Require that financial professionals make disclosures pursuant to MSRB Rule G-17 and disclose any conflicts of interest that may exist, as well as the name(s) of any person or firm compensated to promote the selection of the underwriter; any existing or planned arrangements between outside professionals to share tasks, responsibilities and fees; the name(s) of any person or firm with whom the sharing is proposed; and the method used to calculate the fees to be earned.
7. Review the Bond Purchase Agreement and Agreement Among Underwriters and ensure that the terms and conditions are acceptable to the issuer and identify issues that need to be negotiated with the underwriters.
8. Openly disclose public-policy issues such as the desire for Minority, Women and Disadvantaged Business Enterprises (MWDBEs) and regional firm participation in the syndicate and the allocation of bonds to such firms as reason for negotiated sale; measure and record results at the conclusion of the sale.
9. Prepare a post-sale summary and analysis that documents the pricing of the bonds relative to other similar transactions priced at or near the time of the issuers bond sale, and record the true interest cost of the sale and the date and hour of the verbal award.

Finally, as noted above, it is important for issuers to become familiar with and understand the Municipal Advisor Rules implications on underwriter responsibilities as discussed in the materials related to the Municipal Advisor Rule.

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Government Finance Officers Association

BEST PRACTICE

Debt Issuance Transaction Costs

BACKGROUND:

State and local governments incur various costs and fees in conjunction with publicly offered bond transactions. This Best Practice provides an overview of the types of costs and fees that an issuer can expect to pay in a typical bond transaction. Finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable and for legitimate services provided to the issuer.

There are two types of costs that issuers incur in the debt issuance process:

Direct Costs of Issuance: Costs that the debt issuer pays directly to financial and legal advisors, the trustee (if any), paying agents, auditors, rating agencies and other providers of services to the issuer. This is in addition to internal costs incurred by your government for staff work or fees to other government departments.

Underwriters Discount: Costs paid indirectly by the issuer to the underwriter of the bonds for services relating to selling the bonds to investors and managing elements of the transaction. These costs are deducted from the proceeds of the bonds by the underwriters at closing and therefore issuers typically do not write a check for these services.

Finance officers also should be aware that certain costs are embedded within the bids received from underwriters in a competitive sale. These costs and fees are usually not specified in a competitive bid and are outside of the issuers control. Such costs include CUSIP fees, DTC fees and certain internal expenses of the bidder.

This Best Practice focuses on direct costs of issuance. Best Practices relating to costs paid by issuers through the underwriters discount may be found in the following Best Practices:

- Selecting Underwriters for Negotiated Bond Sales
- Expenses Charged by Underwriters in Negotiated Sales

Finance officers, working with their financial advisor, should understand all costs and fees, so that they can be controlled and managed throughout the financing process. A thorough discussion with the financial advisor and other professionals involved in the transaction should be expected. These discussions should occur at the time that compensation is being determined for key members of the financing team, including the financial advisor, bond counsel and other service providers. As always, cost must be balanced with quality, as it is of critical importance that the issuer receives high quality services and work products from all parties.

RECOMMENDATION:

GFOA recommends that finance officers be aware of the parties likely and necessary to be involved in the transactions and be prepared to select these parties in a manner that ensures that needed services are obtained at a fair and reasonable cost. Additionally, an issuer should carefully review all invoices to ensure that an expense is not billed to multiple parties.

1. **Financial Advisor.** Financial advisors assist the issuer on matters such as selecting the method of sale (competitive, negotiated, private placement, direct bank loan, etc.), structuring the financings, sale timing, marketing, fairness of pricing, obtaining credit ratings, evaluating cost effectiveness of credit enhancement and other matters. Unlike the underwriter of the bonds, the financial advisor has a fiduciary obligation to represent the interests of the issuer and therefore, should be one of the first financing team members retained by the issuer.

   The financial advisor should typically be retained prior to selection of the remainder of the financing team and should assist the issuer in determining the appropriate method sale, the selection of other members of the financing team and the negotiation of fees of the financing team members. GFOA recommends that financial advisors be selected as the result of an RFP or RFQ process. Compensation paid to financial advisors can vary based on the scope of services to be provided. If an advisor is being retained for services related to a bond transaction only, then the complexity of the transaction, the type of security and the type of issuer will have an impact on the fees charged. Fees can be paid on an hourly, or fixed fee bases. However, the FA fee may also be based on an $/$1,000 of par value. However, an issuer should use caution if using this payment method, as it could impact the overall size and structure of the transaction.
2. **Legal Counsel.**
   1. *Bond Counsel.* Bond counsels duty is to represent the interests of the bondholders. Bond counsel is retained by the issuer to give a legal opinion that:
      1. Issuer is authorized to issue proposed municipal securities and has met all legal and procedural requirements necessary for issuance.
      2. If interest on the proposed securities will be excluded from gross income of the holders (Federal and/or State and or local)
      3. Generally responsible for the preparation of financing documents including Trust Indenture and Bond Resolution; assists with preparation of the Official Statement
         Compensation paid to bond counsel varies depending on complexity of the transaction, the type of security and the type of issuer. These fees can be assessed based on a flat fee or by hourly billing. If the fee is paid by $/$1,000 of par value of the issuance, an issuer should use caution and ensure a reasonable cap is in place.
   2. *Issuer Counsel.* Governments may have in house counsel or may hire outside counsel to represent only the interest of the issuer.
   3. *Disclosure or Tax Counsel.* In addition to bond counsel, some transactions will involve the use of disclosure counsel and tax counsel.
3. **Bond Trustee.** A financial institution or other required entity with trust powers that acts in a fiduciary capacity for the benefit of the bondholders, enforcing the terms of the trust indenture and often acting as:
   1. Paying agent (transmitting payments from issuer to bondholder)
   2. Dissemination agent (for ongoing disclosure requirements)
   3. Escrow agent on refunding transactions (hold funds in escrow account until time of disbursement)
   4. Disburse bond proceeds based upon procedures established by trust endenture or bond resolution.
   5. Place investment of bond proceeds based on instruction of issuer.
   6. Trustee fees frequently include a one-time upfront fee (acceptance fee), an annual fee (trusteeship fee), and often transaction fees. The selection of the Trustee should be

done through an RFP process, with price not being the sole determining factor.

4. **Escrow Verification Agent.** An escrow verification agent should be hired in conjunction with a refunding transaction. The role of the escrow verification agent is to determine that the cash flow from the securities purchased to defease the refunded bonds will be sufficient to make remaining debt service payments on the refunded bonds until the bonds are called, if applicable, or to maturity. It is recommended that the selection of an escrow verification agent is competitively procured.
5. **Auditor.** Under auditing standards generally accepted in the United States of America, independent auditors are presumed not to be associated with financial statements included in an offering statement. Still, an association may be created between the independent auditor and the offering statement if the auditor takes one of several actions specified in the auditing standards, such as inserting a provision in the audit contract that requires prior approval before including audited financial statements in an offering statement. It is important to note that the audited financial statements belong to the issuer, which GFOA believes should be free to publish in offering statements. Audit contracts in general should be negotiated to reflect this, but to the extent that consent is required, the level of effort required is minimal and no additional fee should be required.
6. **Rating Agencies.** Rating agency fee quotes can be obtained by your financial advisor or a member of your staff. The fees are and should be considered negotiable. Fees vary by bond size and security type. Consideration should be given to how many ratings are necessary, through discussion with your financial advisor and underwriter. Additionally, considerable caution should be exercised if a rating agency requests that an issuer sign a rating application or rating engagement letter. Legal counsel must be consulted if an issuer is inclined to sign such documents, because they are binding contracts.
7. **Printing and Distribution Costs.** Issuers will typically incur costs relating to electronically posting their official statement to websites and information services that potential underwriters and investors rely upon to access information about proposed bond offerings. In some cases, traditional hard copy printing costs may also be incurred. It has become more common for POS to be electronically posted and for a small number of final OS to be printed. The use of electronic only copies for the POS can save on printing costs.
8. **Pricing Verification Agent.** Issuers should use the services of the financial advisor for the transaction, or obtain the services of a separate financial advisor or other outside professional to review the pricing of a transaction and the underwriters discount. This fee is usually based on a fixed rate basis.

References:

- GFOA Best Practice, Expenses Charged by Underwriters in Negotiated Sales (2012)
- GFOA Best Practice, Pricing Bonds in a Negotiated Sale (2009)
- GFOA Best Practice, Issuers Role in Selecting Underwriters Counsel (2009)
- GFOA Best Practice, Selecting Underwriters for Negotiated Bond Sales (2008)
- GFOA Best Practice, Selecting Bond Counsel (2008)
- GFOA Best Practice, Selecting Financial Advisors (2008)
- GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2007)
- GFOA Advisory, Auditor Association with Financial Statements Included in Offering Statements or Posted on Web Sites (2006)

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Government Finance Officers Association

BEST PRACTICE

Debt Management Policy

BACKGROUND:

Debt management policies are written guidelines, allowances, and restrictions that guide the debt issuance practices of state or local governments, including the issuance process, management of a debt portfolio, and adherence to various laws and regulations. A debt management policy should improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and therefore is likely to meet its debt obligations in a timely manner. Debt management policies should be written with attention to the issuers specific needs and available financing options and are typically implemented through more specific operating procedures. Finally, debt management policies should be approved by the issuers governing body to provide credibility, transparency and to ensure that there is a common understanding among elected officials and staff regarding the issuers approach to debt financing.

RECOMMENDATION:

GFOA recommends that state and local governments adopt comprehensive written debt management policies. These policies should reflect local, state, and federal laws and regulations. To assist with the development of these policies GFOA recommends that a governments Debt Management Policy (Policy) should be reviewed periodically (and updated if necessary) and should address at least the following:

1. *Debt Limits*. The Policy should consider setting specific limits or acceptable ranges for each type of debt. Limits generally are set for legal, public policy, and financial reasons.

a. *Legal restrictions* may be determined by:

- State constitution or law,
- Local charter, by-laws, resolution or ordinance, or covenant, and
- Bond referenda approved by voters.

b. *Public Policies* will address the internal standards and considerations within a government and can include:

- Purposes for which debt proceeds may be used or prohibited,
- Types of debt that may be issued or prohibited,
- Relationship to and integration with the Capital Improvement Program, and
- Policy goals related to economic development, including use of tax increment financing and public-private partnerships.

c. *Financial restrictions or planning considerations* generally reflect public policy or other financial resources constraints, such as reduced use of a particular type of debt due to changing financial conditions. Appropriate debt limits can have a positive impact on bond ratings, particularly if the government demonstrates adherence to such policies over time. Financial limits often are expressed as ratios customarily used by credit analysts. Different financial limits are used for different types of debt. Examples include:

- *Direct Debt, including general obligation bonds*, are subject to legal requirements and may be able to be measured or limited by the following ratios:
  - Debt per capita,
  - Debt to personal income,
  - Debt to taxable property value, and
  - Debt service payments as a percentage of general fund revenues or expenditures.

- *Revenue Debt* levels often are limited by debt service coverage ratios (e.g., annual net pledged revenues to annual debt service), additional bond provisions contained in bond covenants, and potential credit rating impacts.
- *Conduit Debt* limitations may reflect the right of the issuing government to approve the borrowers creditworthiness, including a minimum credit rating, and the purpose of the borrowing issue. Such limitations reflect sound public policy, particularly if there is a contingent impact on the general revenues of the government or marketability of the governments own direct debt.
- *Short-Term Debt Issuance* should describe the specific purposes and circumstances under which it can be used, as well as limitations in term or size of borrowing.
- *Variable Rate Debt* should include information about when using non-fixed rate debt is acceptable to the entity either due to the term of the project, market conditions, or debt portfolio structuring purposes.

2. *Debt Structuring Practices*. The Policy should include specific guidelines regarding the debt structuring practices for each type of bond, including:

- Maximum term (often stated in absolute terms or based on the useful life of the asset(s)),
- Average maturity,
- Debt service pattern such as equal payments or equal principal amortization,
- Use of optional redemption features that reflect market conditions and/or needs of the government,
- Use of variable or fixed-rate debt, credit enhancements, derivatives, short-term debt, and limitations as to when, and to what extent, each can be used, and
- Other structuring practices should be considered, such as capitalizing interest during the construction of the project and deferral of principal, and/or other internal credit support, including general obligation pledges.

3. *Debt Issuance Practices*. The Policy should provide guidance regarding the issuance process, which may differ for each type of debt. These practices include:

- Selection and use of professional service providers, including an independent financial advisor, to assist with determining the method of sale and the selection of other financing team members,

- Criteria for determining the sale method (competitive, negotiated, private placement) and investment of proceeds,

- Use of comparative bond pricing services or market indices as a benchmark in negotiated transactions, as well as to evaluate final bond pricing results,

- Criteria for issuance of advance refunding and current refunding bonds, and

- Use of credit ratings, minimum bond ratings, determination of the number of ratings, and selection of rating services.

4. ***Debt Management Practices***. The Policy should provide guidance for ongoing administrative activities including:

- Investment of bond proceeds,
- Primary and secondary market disclosure practices, including annual certifications as required,
- Arbitrage rebate monitoring and filing,
- Federal and state law compliance practices, and
- Ongoing market and investor relations efforts.

5. ***Use of Derivatives***. The Debt Management Policy should clearly state whether or not the entity can or should use derivatives. If the policy allows for the use of derivatives, a separate and comprehensive derivatives policy should be developed (see GFOAs Advisory, Developing a Derivatives Policy and Derivatives Checklist).

Notes:

- Post Issuance Compliance Checklist
- Debt Issuance Checklist: Considerations When Issuing Bonds

References:

- GFOA Advisory, Using Variable Rate Debt Instruments, 2010.
- GFOA Advisory, Use of Debt-Related Derivatives Products and the Development of a Derivatives policy, 2010.
- GFOA Derivatives Checklist, 2010.
- GFOA Best Practice, Selecting Bond Counsel, 2008.
- GFOA Best Practice, Selecting Financial Advisors, 2008.
- GFOA Best Practice, Selecting Underwriters for a Negotiated Bond Sale, 2008.
- GFOA/NABL Post Issuance Compliance Checklist, 2003.
- *Benchmarking and Measuring Debt Capacity*, Rowan Miranda and Ron Picur, GFOA, 2000.
- *A Guide for Preparing a Debt Policy*, Patricia Tigue, GFOA, 1998.

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