

# **City of Manhattan**

## **Long-Term Obligation (LTO) Financing Policy**

*A Strategy for the Acquisition or Replacement of City Assets*

### **PURPOSE**

The Long-Term Obligation Financing (LTO) Policy Statement sets forth comprehensive guidelines for the financing of capital expenditures. It is the objective of the policies that (1) the City obtain financing only when necessary, (2) the process for identifying the timing and amount of LTO or other financing be as efficient as possible and (3) the most favorable interest rate and other related costs be obtained.

LTO financing, to include general obligation bonds, special assessment bonds, revenue bonds, temporary notes, lease/purchase agreements, and other City obligations permitted to be issued or incurred under Kansas law, shall only be used to purchase capital assets that cannot be acquired from either current revenues or fund balances needed to fund infrastructure improvements and additions. The useful life of the asset or project shall exceed the payout schedule of any LTO the City assumes.

To enhance creditworthiness and prudent financial management, the City is committed to systematic capital planning, intergovernmental cooperation and coordination, and long-term financial planning. Evidence of this commitment to capital planning will be demonstrated through adoption and periodic adjustment of the City's Comprehensive Plan and the adoption of an annual Capital Improvement Plan (CIP).

### **RESPONSIBILITY FOR POLICY**

The primary responsibility for developing LTO financing recommendations rests with the Director of Finance for the City of Manhattan. In developing such recommendations, the Finance Director shall be assisted by the Assistant Director of Finance and the City Treasurer, the three of whom shall comprise the LTO Management Committee. The responsibilities of this Committee shall be to:

- meet at least semi-annually to consider the need for LTO financing and assess progress on the current Capital Improvement Program and any other program/improvement deemed necessary by the City Manager;
- meet at least semi-annually to test adherence to this policy statement and to review applicable LTO ratios serving as benchmarks;
- review changes in federal and state legislation that affect the City's ability to issue LTO's and report such findings to the City Manager as appropriate;
- review annually the provisions of ordinances authorizing issuance of general obligation bonds of the City;
- review semi-annually the opportunities for refinancing current long-term obligations; and,
- review annually the services provided by the City's financial advisor, bond trustees, bond counsel, paying agents and other LTO financing service providers.

Prior to meeting, the City Treasurer shall prepare a written report on the financial status of the City's current Capital Improvement Program. The report shall be based in part on information collected from departmental managers for the City and shall include a projection of near term financing needs compared to available resources, an analysis of the impact of contemplated financings on the property tax rate and user charges, and a final financing recommendation.

In developing financing recommendations, the LTO Management Committee shall consider:

- the time proceeds of obligations that are expected to remain on hand and their related carrying costs;
- the options for interim financing including short term and inter-fund borrowing, taking into consideration federal and state reimbursements;
- the effect of proposed actions on the tax rate and user charges;
- trends in bond markets;
- trends in interest rates; and,
- other factors as deemed appropriate.

## **USE OF LONG-TERM OBLIGATION FINANCING**

LTO financing will not be considered appropriate for any recurring purpose such as current operating and maintenance expenditures. The City will use LTO financing only for one-time capital improvement projects and unusual equipment purchases included under the following circumstances:

- when the project is included in the City's six-year capital improvement program and is in conformance with the City's general plan;
- when the project is not included in the City's six-year capital improvement program, but it is an emerging need whose timing was not anticipated in the six-year capital improvement program, or it is a project mandated immediately by state or federal requirements, or it is a project for which grant money has been offered and the matching funds are not readily available from other sources;
- when the project is the result of growth-related activities within the community that require unanticipated and unplanned infrastructure or capital improvements by the City;
- when the project's useful life, or the projected service life of the equipment, will be equal to or exceed the term of the financing; and,
- when there are designated revenues sufficient to service a LTO, whether from project revenues, other specified and reserved resources, or infrastructure cost sharing revenues.

The following criteria will be used to evaluate pay-as-you-go versus LTO financing in funding capital improvements:

*Factors which favor pay-as-you-go LTO financing include circumstances where:*

- current revenues and fund balances that are available;
- a phasing-in of projects is feasible;
- additional LTO levels would adversely affect the City's credit rating; or,
- market conditions are unstable or suggest difficulties in marketing a LTO.

*Factors which favor long-term LTO financing include circumstances where:*

- revenues available for LTO issues are considered sufficient and reliable so that long-term financing can be marketed with an appropriate credit rating, which can be maintained;
- market conditions present favorable interest rates and demand for City LTO financing;
- a project is mandated by state or federal government and current revenues or fund balances are insufficient to pay project costs;
- a project is immediately required to meet or relieve capacity needs; or
- the life of the project or asset financed is five years or longer.

## **STRUCTURE AND TERM OF LONG-TERM OBLIGATION FINANCING**

### *General*

City LTOs will be structured to achieve the lowest possible net interest cost to the City given market conditions, the urgency of the capital project, and the nature and type of any security provided. Moreover, to the extent possible, the City will design the repayment of its overall LTO issues so as to rapidly recapture its credit capacity for future use. As a benchmark, the City shall strive to repay at least 20% of the principal amount of its general obligation bonds, excluding special assessment bonds, within five years and at least 40% within ten years.

### *General Obligation Bonds*

The City shall use an objective analytical approach to determine whether it can afford to assume new general obligation bonds beyond what it retires each year (*see Assumption of Additional LTOs below*). Generally, this process will compare City Commission approved benchmarks relative to key demographic data of the City.

These benchmarks shall include, at a minimum, ratios reflecting LTOs per capita, LTOs as a percent of taxable value, LTO service payments as a percent of current revenues and current expenditures, and the level of overlapping net LTO of all local taxing jurisdictions. This process shall also examine the direct costs and quantifiable benefits of any proposed expenditures.

The decision on whether or not to assume new general obligation bonds shall, in part, be based on (a) costs and benefits, (b) the current conditions of the municipal bond market, and (c) the City's ability to assume new general obligation bonds as determined by the aforementioned benchmarks.

**NOTE:** *The provisions of this section also apply to the issuance of any private activity bonds.*

### *Revenue Bonds*

For the City to issue new revenue bonds, projected annual revenues as defined by the ordinance authorizing such issuance, shall be a minimum of 125% of the issue's average annual revenue bond service. If necessary, annual adjustments to the City's rate structures will be considered in order to maintain 125% coverage factor.

### *Special Assessment Bonds*

The City shall maintain a watchful attitude over the issuance of special assessment bonds for benefit district improvements. While the City's share of any benefit district project may fluctuate, under Kansas law, the City will not pay more than 95% of any proposed costs related to a benefit district. Further, it will be the responsibility of the LTO Management Committee to analyze each special assessment bond issue for indications that future property taxes will equal or exceed the annual principal and interest payments on the annual amortization of such bonds. A report on the findings of the LTO Management Committee will be submitted to the City Manager prior to the City Commission approval of any special assessment bond issue.

### *Assumption of Additional Long-Term Obligations*

The City shall not assume more tax-supported general obligation bond debt (excluding special assessment bonds) than it retires each year without conducting an objective analysis as to the community's ability to assume and support additional general obligation bond service payments. Whenever appropriate, self-supporting revenue bonds shall be issued before general obligation bonds.

### *Asset Life*

The City will consider long-term financing for the acquisition, replacement, or expansion of physical assets (including land) only if a capital project has a useful life longer than the term of the bond issue supporting it. LTOs will be used only to finance capital projects and equipment, except in case of unforeseen emergencies. LTOs will not be issued for periods exceeding the useful life or average useful lives of the project or projects to be financed.

### *Long-Term Obligation Guarantees With Other Intergovernmental Agencies*

The City may consider, on a case-by-case basis, the use of its LTO capacity for legally allowable capital projects by public development authorities or other special purpose units of government. The City's guarantee of LTO service coverage will be made only (1) after the prior commitment of the full assets and resources of the development authority to LTO coverage; (2) if project revenues, or development authority revenues pledged to LTO service, are at least equal to LTO service; (3) if LTO service reserves are provided by the development authority's own resources and are equal to at least six months LTO service; and, (4) if all other viable means financing have been examined.

### *Length of Long-Term Obligations*

City LTOs will be amortized for the shortest period consistent with a fair allocation of costs to current and future beneficiaries or users.

The City normally shall issue bonds with an average life of 15 years or less for general obligation bonds and 20 years for revenue bonds and special assessment bonds. (However, there may be special circumstances when the cost of a project necessitates a bond life greater than 15 years.) When feasible, the structure of general obligation bonds will reduce principal at a faster rate than amortization of revenue bonds or special assessment bonds. There shall be no "balloon" bond repayment schedules, which consist of low annual payments and one large payment of the balance due at the end of the term. There shall always be at least interest paid in the first fiscal year after a bond sale and principal starting no later than the second fiscal year after the bond issue.

### *Call Provisions*

Call provisions for bond issues shall be made as short as possible consistent with the lowest interest cost to the City. All bonds shall be callable only at par.

### *Long-Term Obligation Structuring*

At a minimum, the City will seek to amortize general obligation bonds with level principal and interest costs-over the life of the issue. Pushing higher costs to future years in order to reduce short-term budget

liabilities will be considered only when natural disasters or extraordinary or unanticipated external factors make the short-term cost of general obligation bonds prohibitive.

#### *Variable Rate Long-Term Obligations*

The City may choose to issue bonds that pay a rate of interest that varies according to pre-determined formula or results from a periodic remarketing of the securities, consistent with state law and covenants of pre-existing bonds, and depending on market conditions.

### **LONG-TERM OBLIGATION ADMINISTRATION AND FINANCING**

#### *Financing Proposals*

Any capital financing proposal of a City division, agency, or utility involving the pledge or other extension of the City's credit through sale of bonds, execution of loans or leases, or otherwise involving directly or indirectly the lending or pledging of the City's credit, shall be referred to the Department of Finance for review before such pledge is considered by the City Commission.

#### *Bond Fund*

All payment of general obligation bonds and special assessment bonds shall be from the City's Bond & Interest Fund. The fund balance in the Bond & Interest Fund will be maintained at a level equal to or greater than the total principal and interest payable from that Fund for the upcoming semi-annual debt service payment.

#### *Bond Counsel*

The City will utilize external bond counsel for all LTO issues. All LTOs issued by the City will include a written opinion by Bond Counsel affirming that the City is authorized to issue the LTO, stating that the City has met all Federal and State constitutional and statutory requirements necessary for issuance, and determining a LTOs federal income tax status.

#### *Underwriter's Counsel*

City payments for Underwriters Counsel will be authorized for negotiated sales by the Department of Finance on a case-by-case basis depending on the nature and complexity of the transaction and the needs expressed by the underwriters.

#### *Financial Advisor*

The City will utilize an external financial advisor, to be selected for a term of up to three years, through a competitive process administered by the City's Finance Department. The utilization of the financial advisor for certain LTO issuance will be at the discretion of the Department of Finance on a case-by-case basis. For each City bond sale the financial advisor will provide the City with information on pricing and underwriting fees for comparable sales by other issuers. Upon expiration of a three-year contract, the City has the option, after a request-for-proposal process, of extending or signing a new contract with the existing Financial Advisor for another three-year period.

### *Temporary Notes*

Use of short-term borrowing, such as temporary notes, will be undertaken only if the transaction costs plus interest on a LTO are less than the cost of internal financing, or available cash or reserves are insufficient to meet project needs or current obligations.

### *Credit Enhancements*

Credit enhancement (letters of credit, bond insurance, etc.) may be used if the costs of such enhancements will reduce the net service payments on the bonds.

### *Lease/Purchase Agreements*

The use of lease/purchase agreements in the acquisition of vehicles, equipment and other capital assets shall be considered carefully relative to any other financing option or a "pay-as-you-go" basis. Although lifetime cost of a lease may be higher than other financing options or if the asset were purchased outright, this will not preclude lease/purchase agreements from being considered by the City as a funding option for certain capital projects.

### *Competitive Sale of Long-Term Obligations*

The City, as a matter of policy, shall seek to issue its general or revenue bond obligations in a competitive sale unless it is determined by the LTO Management Committee that such a sale method will not produce the best results for the City. In such instances where the City, through a competitive bidding for its bonds, deems the bids received as unsatisfactory or does not receive bids, it may, at the election of the City Commission, enter into negotiation for sale of the bonds.

## **REFUNDING OF LONG-TERM OBLIGATIONS**

Periodic reviews of all outstanding LTOs will be undertaken to determine refunding opportunities. Refunding will be considered (within federal tax law constraints) if and when there is a net economic benefit of the refunding or the refunding is essential in order to modernize covenants essential to operations and management.

City staff and the financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding LTOs. As a general rule, the present value savings of a particular refunding will exceed 3% of the refunded maturities.

Refunding issues that produce a net present value savings of less than 3% percent will be considered on a case-by-case basis. Refunding issues with negative savings will not be considered unless there is a compelling public policy objective.

## **CONDUIT FINANCINGS**

The City may sponsor conduit financings in the form of Industrial Revenue Bonds for those activities (i.e., economic development, housing, health facilities, etc.) that have a general public purpose and are consistent with the City's overall service and policy objectives as determined by the City Commission.

All conduit financings must insulate the City completely from any credit risk or exposure and must first be approved by the City Manager before being submitted to the City Commission for consideration.

## **ARBITRAGE LIABILITY MANAGEMENT**

It is the City's policy to minimize the cost of arbitrage rebate and yield restriction while strictly complying with the law.

### *General*

Federal arbitrage legislation is intended to discourage entities from issuing tax-exempt obligations unnecessarily. In compliance with the spirit of this legislation, the City will not issue obligations except for identifiable projects with very good prospects of timely initiation. Temporary notes and subsequent general obligation bonds will be issued timely as project contracts are awarded so that LTO issues will be spent quickly.

### *Responsibility*

Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, the advice of Bond Counsel and other qualified experts will be sought whenever questions about arbitrage rebate regulations arise.

## **CREDIT RATINGS**

### *Rating Agency Relationships*

The Director of Finance and the LTO Management Committee shall be responsible for maintaining relationships with the rating agencies that currently assign ratings to the City's various LTOs. This effort shall include providing periodic updates on the City's general financial condition along with coordinating meetings and presentations in conjunction with a new LTO issuance.

### *Use of Rating Agencies*

The LTO Management Committee shall be responsible for determining whether or not a rating shall be requested on a particular financing and which of the major rating agencies shall be asked to provide such a rating.

### *Minimum Long-Term Rating Requirements*

The City's minimum rating requirement for its direct, long-term, LTO obligations is a rating of "AA" or higher. If a given LTO cannot meet this requirement based on its underlying credit strength, then credit enhancement may be sought to ensure that the minimum rating is achieved. If credit enhancement is unavailable or is determined by the LTO Management Committee to be uneconomical, then the obligations may be issued without a rating.

### *Rating Agency Presentations*

Full disclosure of operations and open lines of communication shall be made to rating agencies used by the City. The LTO Management Committee, with assistance of the City's Financial Advisor, shall prepare the necessary materials and presentation to the rating agencies. Credit rating will be sought from any rating agency as recommended by the City's LTO Management Committee.

### *Financial Disclosure*

The City is committed to full and complete financial disclosure, and to cooperating fully with rating agencies, institutional and individual investors, City departments and agencies, other levels of government, and the general public to share clear, comprehensible, and accurate financial information. The City is committed to meeting secondary disclosure requirements on a timely and comprehensive basis.

Official statements accompanying LTO issues, Comprehensive Annual Financial Reports, and continuous disclosure statements will meet (at a minimum), the standards articulated by the Government Accounting Standards Board (GASB), the National Federation of Municipal Analysts, the Securities and Exchange Commission (SEC), and Generally Accepted Accounting Principles (GAAP). The Department of Finance shall be responsible for ongoing disclosure to established national information repositories and for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies.

## Appendix

# City of Manhattan

## LTO Management Policy

### TERMINOLOGY

**Arbitrage.** Arbitrage refers to the rebate amount due to the Internal Revenue Service where funds received from the issuance of tax-exempt debt have been invested and excess interest earnings have occurred.

**General Obligation Bonds.** Bonds backed by the full faith and credit of the City. The taxing power may be an unlimited ad valorem tax or a limited tax, usually on real estate and personal property. A special tax rate levied for the Bond & Interest Fund annually to pay for general obligation LTO service. Because it is secured by an unlimited tax levy, this structure has strong marketability and lower interest costs.

**Municipal Leases Agreements.** The City enters into a lease agreement with another party (typically a third-party vendor) to lease an asset over a defined period of time at a prearranged annual payment. Lease payments are made primarily from general fund revenues. The legislative body has to appropriate annual LTO service payments unless it chooses not to appropriate under the Kansas cash basis law. For the security of the leaseholders, a reserve fund is normally established and held by a trustee until all bonds are paid.

**Revenue Bonds.** Bonds secured by revenues generated by the facility from dedicated user fees. Planning for such issues generally are more complex because future costs and revenues directly affect each other. Credit enhancements (e.g., insurance or letter of credit) may be needed because of the limited source of LTO service payments that may be available in outlying years.

**Special Assessment Bonds.** Bonds issued to develop facilities and basic infrastructure for the benefit of properties within the assessment district. Assessments are levied on properties benefited by the project. The issuer's recourse for nonpayment is foreclosure and the remaining LTO becomes the City's direct obligation.

**Temporary Notes.** Notes are issued to provide temporary financing, to be repaid by long-term financing. This type of bridge financing has a maximum maturity of four years under Kansas law.