

# Debt Management Guidelines

## Updated 9/10/2014

Purpose: These guidelines are intended to add clarity to the debt management goals and objectives stated in the Debt Management Policy taking into account sound fiscal management, the District's capital needs and evolution of the financial markets.

### A. Method of Sale

The following table outlines the issues to be considered when determining the appropriate method of sale.

	<u><b>Competitive Sale</b></u>	<u><b>Negotiated Sale</b></u>
<b>Issuer</b>		
Type of Organization	Broad-based, general-purpose government	Special-purpose, independent authority
Frequency of Issue	Regular borrower in public market	New or infrequent issuer of debt
Market Awareness	Active secondary market with wide investor base	Little or no institutional base, but growing dealer interest
<b>Credit Quality</b>		
Rating	"A" or better	Below "A"
Pledged Revenues	General obligation	Project supported revenues
Security Structure	Conventional resolution and cash flow; rate covenant and coverage	Unusual or weak covenants; subordinate debt
Trend	Stable	Improving or under stress
<b>Market Conditions</b>		
Interest Rates	Stable, predictable market	Volatile or declining market
Demand	Strong investor demand, good liquidity, light forward calendar	Oversold market, heavy supply
<b>Debt Structure</b>		
Tax Status	Tax-exempt, no concerns	Taxable
Debt Instrument	Traditional serial and term, full-coupon bonds	Aggressive use of innovative bond structuring, derivative products, swaps or variable rate debt instruments
<b>Marketing</b>		
Use of Underwriters	Broad market participation banker and direct business to local or regional firm	Ability to select "best qualified"
Investors	Process blind to ultimate investors	Sale can be managed to achieve wide distribution or targeted allotments
Pre-Marketing	Limited needs for pre-marketing	Specific pre-sale activity to generate demand
Flexibility in Timing	Limited flexibility	Greatest flexibility in timing
Fine Tuning Structure	Limited options given to bidders	Unlimited ability to fine tune
<b>Cost</b>		
Gross Spread	Historically, spreads have been lower	Recent data shows comparable spreads
Interest Rates	Highest market price for commodity offered on day of sale	Best match of product with specific investor demand
<b>Preparation</b>		
Resolution/Structure	Issuer determines own preference for managing	Professional banking support and more direct marketing input in balancing security for investors vs. flexibility for issuer
Disclosure	Issuer relies on own program disclosure	Underwriter's counsel assists in the preparation of Official Statement

Certificates of Participation (COPs) have become the primary vehicle for financing educational facilities in Florida. While COPs are common in Florida, they are still primarily sold via negotiated sale due to the unique structure associated with each specific financing.

## **B. Debt Structure**

### **Principal Amortization**

Amortization of principal resulting in level debt service is preferred since this structure matches useful life of the asset with the financing. Accelerated structures and wrap around structures which result in aggregate level debt service may be appropriate at certain times over the course of a 20 to 30 year capital financing cycle in order to facilitate the total capital plan. However, both accelerating and deferring principal can impact long-term capital plans negatively and should be used sparingly.

### **Interest Rate Mode**

Fixed rate obligations are most common for municipal issuers. Tax-exemption results in relatively low interest rates when compared to corporate debt. Debt service for fixed rate obligations is defined resulting in less risk when preparing budgets. At the same time, variable rate obligations have historically resulted in significantly lower interest rates. Large issuers with substantial debt and assets can take advantage of the expected lower cost of variable rate obligations with limited risk to net cash flow by issuing a reasonable amount of variable rate obligations.

The following guidelines are set after consultation with rating agencies and insurance companies.

- Variable rate thresholds – (1) No more than 50% of the District’s obligations may be issued in a variable rate mode. (2) At any given point in time, no more than 25% of the District’s outstanding debt will be unhedged variable rate obligations. Variable rate obligations that have been hedged by a variable to fixed rate interest rate swap for a period greater than the lesser of (i) five years or (ii) 75% of the remaining life of the obligation will not be considered variable rate obligations for this section (2).
- Budgeting debt service – The District will use the following procedures for budgeting debt service payments:
    - 1) Fixed rate debt – the actual debt service
    - 2) Variable rate obligations that have been swapped to a fixed rate
      - Bond rate swap – actual swap rate
      - Tax exempt index swap – swap rate plus 0.25% of the principal amount of the swapped debt
      - Taxable index swap - swap rate plus 0.75% of the principal amount of the swapped debt
    - 3) Variable rate obligations (actual variable rate or swapped to variable rate) the greater of:
      - Twelve month average plus 0.50%

- Most recent rate plus 0.50%
- 4) Debt service budget will include all costs for liquidity facilities, letters of credit, remarketing fees and other ongoing costs.

### **C. Refunding/Restructuring Savings Criteria**

The Debt Management Policy provides for a 3% net present value savings threshold, with the cashflows discounted using the yield as defined in the Code. This general criterion will be adjusted on a case-by-case basis after considering option value, opportunity cost, rating agency/insurer criteria and risks associated with the proposed refunding transaction. For example, a materially higher savings threshold will generally be required for refunding transactions incorporating hedges and forward structures. Conversely, certain refundings (generally refundings with a very short duration) may be recommended that possess a lower savings threshold. The District may also refund existing debt for the purpose of revising legal covenants to meet particular organizational and/or strategic needs of the District. District staff and the Financial Advisor will make savings threshold recommendations for each transaction after evaluating market and risk factors.

### **D. Interest Rate Hedge Contracts**

#### **Procurement**

The use of hedging products should be considered carefully. If deemed appropriate, swaps should be procured via a competitive process whenever practical. Swaps

#### **Qualifications of Counterparties**

A counterparty must have demonstrated experience in successfully executing hedge transactions and be active in the municipal marketplace. A counterparty shall have (i) a credit rating equal to or higher than the District's or (ii) credit ratings from at least one nationally recognized statistical rating agency that is within the two highest rating categories ("AAA" or "AA"), and ratings from any other nationally recognized statistical rating agencies shall be within the three highest investment grade categories ("A" or better), or the payment obligations of the counterparty shall be collateralized or unconditionally guaranteed by an entity with such credit ratings. If counterparty credit ratings are such that the Finance Committee determines that the rating criteria cannot be met by significant municipal market participants that participate in the hedge market, the Finance Committee will adjust the rating criteria to reflect then current market factors.

The District may procure hedges by negotiated methods in the following situations:

- Due to size or complexity of a particular swap, a negotiated transaction would result in the most favorable pricing.
- A hedge is embedded within a proposed bond issue.
- Market entry/timing constraints suggest a negotiated sale.
- A negotiated transaction will promote the District's interests by encouraging and rewarding innovation.

#### **Form and Content of Hedge Contract**

In preparing the agreement, the District should generally provide for:

- Termination of the agreement at the market value of the agreement at any time. Generally, the counterparty shall **not** have the right to optionally terminate an agreement.
- Events of default of counterparty shall include:
  1. Failure to make payments when due
  2. Breach of representations and warranties
  3. Illegality
  4. Failure to comply with downgrade provisions
  5. Failure to comply with any other provisions of the agreement after a specified notice period.
- Posting of collateral by the counterparty or insurance
- Prior to entering, amending, or terminating any swap, the District will consider and meet all applicable legal and regulatory requirements for swap transactions in consultation with its advisors and legal counsel. The District will consider relevant advisories and maintain full compliance prior to entering, amending, or terminating any swap and in particular provide ongoing monitoring of compliance with the following entities:
  - CFTC (Commodity Futures Trading Commission)
  - GFOA (Government Finance Officers Association)

### **Counterparty exposure**

The District's goal is to maintain diversity among counterparties. At the time the District enters into a hedge, no more than 35% of the total principal amount of hedge obligations outstanding should be with a single counterparty (treating each separately capitalized entity with a separate rating as a single counterparty). Considerations: (1) If the District's swap portfolio is small portion of the debt portfolio, diversification may not be cost effective so at the Finance Committee's recommendation, the threshold can be exceeded. (2) The District will manage the swap portfolio taking into consideration credit factors, the number of firms providing hedges and other market dynamics, which may lead to higher concentrations with certain counterparties.

### **E. Conclusion**

These guidelines are being applied to financial products that change constantly. The guidelines should be adjusted frequently to reflect evolution of financial products in order to maintain a sound, prudent and cost effective debt program.