

CAPITAL FINANCING AND DEBT MANAGEMENT POLICY

CITY OF STOCKTON

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CITY OF STOCKTON CAPITAL FINANCING & DEBT MANAGEMENT POLICY

I. Introduction

So as to maintain the highest quality capital financing and debt management program, the City of Stockton has prepared the guidelines and policies set forth in this document, referred to hereafter as the “Debt Management Policy.” The Debt Management Policy is intended to guide decisions related to debt supported by the City’s General Fund, Enterprise Funds and any other related funding entities. In addition to this policy, there is a separate policy for land-secured financing and debt issued by the Redevelopment Agency.

To the extent that items have not been contemplated for inclusion in the Debt Management Policy, additions and revisions can be made by approval of the Debt Policy Committee to be formally added to the Debt Management Policy through the annual review process.

Goals and Objectives

The Debt Management Policy formally establishes parameters for issuing debt and managing a debt portfolio which encompasses the City’s specific capital improvement needs and its ability to repay financial obligations utilizing a long range financial planning approach. Specifically, the policies outlined in this document are intended to guide the City in the following:

- Evaluating critical debt issuance options.
- Promoting sound financial management that utilizes long range financial planning.
- Providing accurate and timely information on financial conditions.
- Maintaining appropriate capital assets for present and future needs.
- Protecting and enhancing the City’s credit rating.
- Ensuring the legal and prudent use of the City’s bonding authority through an effective system of financial security and internal controls.
- Promoting cooperation and coordination with other public entities and the private sector in the financing and delivery of services.
- Use debt financing where appropriate to match projected revenue streams with facility needs.

II. Approach to Financing Long-term Debt

A sound debt management program integrates pay-as-you-go project financing with projects financed through the issuance of long-term debt. The City's Capital Improvement Program utilizes this combined approach to fund the City's capital projects. Therefore, it is important to integrate the City's Debt Management Policy with both the City's long range financial plan and the capital improvement program. Debt issuance for capital projects should not be considered unless such issuance has been incorporated into the capital improvement program.

The City's Debt Management Policy promotes the use of debt only in those cases where public policy, equity, and economic efficiency favor debt over cash (i.e., pay-as-you-go) financing. When considering how to fund capital improvements the City will use the following criteria to evaluate whether to fund the improvement project on a pay-as-you-go basis versus the use of long-term debt financing:

Factors Favoring Pay-As-You-Go Financing

- Current revenues and adequate fund balances are available such that project phasing can be accomplished.
- Useful life of the capital asset is 10 years or less.
- Existing debt levels might have an adverse impact on the City's credit rating.
- Market conditions are unstable or present difficulties in marketing the improvement project.

Factors Favoring Long-term Financing

- Revenues available for debt service are sufficient and reliable such that long-term financings can be marketed with an investment grade credit rating.
- The project securing the financing is of the type which will support an investment grade credit rating.
- Market conditions present favorable interest rates.
- The project is required to meet or relieve capacity needs and current resources are insufficient or unavailable.
- The life of the project or capital asset to be financed is 10 years or longer.

Notwithstanding the above considerations, the City may consider the use of long-term debt in special circumstances for projects other than capital projects to better manage its assets and liabilities over time, including Tax and Revenue Anticipation Notes

and/or Pension Obligation Bonds, with the latter being considered only after careful policy evaluation by the City.

III. Debt Management and Capacity

- **Use of the General Fund as a Back-up Guarantor.** The City's General Fund may be used to provide back-up liquidity to improve the credit rating of a self-supported debt issue (i.e., an obligation that is expected to be paid through specific revenues), but only if the General Fund is not exposed to significant risk of loss of assets or impairment of liquidity. The evaluation of risk should consider the following factors:
 - Volatility and collection risk of the revenue source identified for repayment of the debt.
 - The likelihood of General Fund reimbursement within one year for any payments it might potentially need to make in its role as back-up guarantor.

The City will not use General Fund financial support for assessment, mello-roos or redevelopment obligations. However, the City may use credit backing for redevelopment obligations.

- **General Purpose Debt Capacity.** The City will carefully monitor its levels of general-purpose debt. In evaluating debt capacity, general purpose supported debt service will not exceed seven percent (7%) of total General Fund budgeted expenditures and transfers out.
- **Enterprise Fund Debt Capacity.** The City will set enterprise fund rates at levels needed to fully cover debt service and coverage requirements, operations and maintenance, administration and capital improvement costs. The ability to afford new debt for enterprise operations will be evaluated as an integral part of the City's rate review and setting process.
- **Inter-fund Loans among City Funds.** Inter-fund loans among City funds will be considered to finance high priority needs on a case-by-case basis, only when the fund making the loan would not be negatively impacted. Inter-fund borrowing may also be used when it would reduce costs of interest, debt issuance, and/or administration. Inter-fund loans require a written and signed loan agreement between the two City entities that includes a repayment schedule with interest paid at the current borrowing rate of the term of the loan. The repayment term of inter-fund loans is limited to five years.

IV. Financing Criteria

When the City determines that the use of debt is appropriate, the following criteria will be utilized to evaluate the type of debt to be issued.

- **Long-Term Debt.** The City may issue long-term debt (e.g., general obligation bonds, revenue bonds, lease obligations, or variable rate bonds) when an appropriate assessment of the need and priority of the capital improvement project has been undertaken, current resources are insufficient to finance the project, and when debt financing is the optimal structure given the City's financial outlook in relation to the long range financial plan. The proceeds derived from long-term borrowing will not be used to finance current operations or normal maintenance. Long-term debt will be structured such that the obligations do not exceed the expected useful life of the respective projects.
 - **Subordinate Debt** (e.g., subordinate or junior lien bonds) may be issued in instances in which statutory or indenture restrictions prevent additional series of parity of senior lien bonds.

- **Short-Term Debt.** Defined as borrowing that spans less than one year, short-term borrowing may be utilized for the temporary funding of operational cash flow deficits or anticipated revenues (defined as an assured source with the anticipated amount based on conservative estimates). The City will determine and utilize the least costly method for short-term borrowing. The City may issue short-term debt when there is a defined repayment source or amortization of principal, subject to the following policies:
 - **Bond Anticipation Notes (BANs)** may be issued instead of capitalizing interest to reduce the debt service during the construction period of a project or facility.
 - **Tax and Revenue Anticipation Notes (TRANS)** should be issued only to meet projected cash flow needs consistent with a finding by bond counsel that the sizing of the issue fully conforms to IRS requirements and limitations.
 - **Lines of Credit** should only be considered as an alternative to other short-term borrowing options. The lines of credit shall be structured to limit concerns as to the Internal Revenue Code.

- **Variable Rate Debt.** To maintain a predictable debt service burden, the City may give preference to debt that carries a fixed interest rate. However, the City may consider variable rate debt in certain instances, such as:
 - **High Interest Rate Environment.** Current interest rates are above historic average trends.
 - **Variable Revenue Stream.** The revenue stream for repayment is variable, and is anticipated to move in the same direction as market-generated variable interest rates, or the dedication of revenues allows capacity for variability.
 - **Adequate Safeguards Against Risk.** Financing structure and budgetary safeguards are in place to prevent adverse impacts from interest rate shifts; such structures could include, but are not limited to, interest rate swaps, interest rate caps and the matching of assets and liabilities.
 - **Variable Rate Debt Capacity.** Consistent with rating agency guidelines, the percentage of variable rate debt outstanding (not including debt which has been converted to synthetic fixed rate debt through a matching swap agreement) shall not exceed 20% of the City's total outstanding debt (excluding land-secured

debt).

- **Tax-Exempt Lease Financed Debt.** Intermediate and long term tax exempt debt financing can also be undertaken for the acquisition of, for example, equipment, information technology enhancements, vehicles or HVAC and other renewal and replacement systems improvements. The parameters for the City to enter into a tax-exempt lease financing agreement is as follows:
 - A minimum threshold of \$200,000 up to a maximum of \$1,000,000 can be tax-exempt lease financed. Special consideration is negotiable for exceptions to be made on a case-by-case basis.
 - Identified repayment revenue resource must be a continuous funding source. Grant awards cannot be identified as the repayment source.
 - Selection of both the projects and tax-exempt financing method must undergo review and approval by both the Budget Division and the Administrative Services Department.
 - The terms of the tax-exempt lease financing may not exceed the useful life of the capital asset.

V. Terms and Conditions of Bonds

The City shall establish all terms and conditions relating to the issuance of bonds, and will control, manage, and invest all bond proceeds. Unless otherwise authorized by the City, the following shall serve as bond requirements:

1. **Term.** All capital improvements financed through the issuance of debt will be financed for a period not to exceed the useful life of the improvements.
2. **Capitalized Interest.** Certain types of financings such as certificates of participation and other lease-secured financings may require the use of capitalized interest from the issuance date until the City has beneficial use and occupancy of the financed project. Interest shall not be funded (capitalized) beyond a period of three years, or a shorter period if further restricted by statute. The City may require that capitalized interest on the initial series of bonds be funded from the proceeds of the bonds. As an alternative to capitalizing interest during the acquisition or construction of a project, the City may lease and lease-back an existing capital asset to secure the financing.
3. **Debt Service Structure. Market conditions at the time of sale will inform the City on its decision regarding debt service structure.** Debt issuance shall be planned to achieve relatively rapid repayment of debt while still matching debt service to the useful life of facilities. The City shall avoid the use of bullet or balloon maturities except in those instances where these maturities serve to levelize existing debt service.
4. **Call Provisions.** In general, the City's securities will include a call feature, which is no later than 10 years from the date of delivery of the bonds. The City will avoid the sale of non-callable bonds absent careful evaluation by the City of the

value of the call option. Every effort shall be made to minimize call premiums which shall not exceed 3% unless required by statute.

5. **Original Issue Discount and Premiums.** An original issue discount or premium will be permitted only if the City determines that such discounts or premiums result in a lower true interest cost on the bonds and that their use will not adversely affect the project identified by the bond documents.
6. **Deep Discount Bonds.** Deep discount bonds may provide a lower cost of borrowing in certain markets. The City will carefully consider their value and effect on any future refinancing as a result of the lower-than-market coupon.
7. **Multiple Series.** In instances where multiple series of bonds are to be issued, the City shall make a final determination as to which facilities are of the highest priority and those facilities which will be financed first, pursuant to funding availability and the proposed timing of facilities development, and which will generally be subject to the earliest or most senior lien.

VI. Credit Enhancements

The City will consider the use of credit enhancement on a case-by-case basis, evaluating the economic benefit versus cost for each case. Only when a clearly demonstrable savings can be shown should a method of enhancement be considered. The City will consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancement.

- **Bond Insurance.** The City shall have the authority to purchase bond insurance when such purchase is deemed prudent and advantageous. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds.
 1. **Provider Selection.** The Director of Administrative Services will solicit quotes for bond insurance (or cause such quotes to be solicited) from interested providers or in the case of a competitive sale submit an application for pre-qualification on insurance. In a negotiated sale, the Director of Administrative Services shall have the authority to select a provider whose bid is the most cost effective and whose terms and conditions governing the guarantee are satisfactory to the City.
- **Debt Service Reserves.** When required, a reserve fund equal to the least of (1) ten percent (10%) of the original principal amount of the bonds, (2) one hundred percent (100%) of the maximum annual debt service, and (3) one hundred and twenty five percent (125%) of average annual debt service, (the "Reserve Requirement") shall be funded from the proceeds of each series of bonds, subject to federal tax regulations and in accordance with the requirements of credit enhancement providers and/or rating agencies. This "three prong" test will also apply to a common reserve fund (parity reserve) calculated on all parity bonds within a series. Policies governing the investment of debt service reserves and bond proceeds can be found in both the bond documents and the City's Investment Policy.

The City may purchase reserve equivalents (i.e., the use of a reserve fund surety

or letter of credit) when such purchase is deemed prudent and advantageous. Such equivalents shall be evaluated in comparison to cash funding of reserves on a net present value basis, taking into account projected interest earnings on a cash funded reserve.

- **Letters of Credit.** The City may enter into a letter-of-credit (“LOC”) agreement when such an agreement is deemed prudent and advantageous. The Director of Administrative Services shall prepare (or cause to be prepared) and distribute to qualified financial institutions as described in the subsection “Selection Criteria” below, a request for qualifications which includes terms and conditions that are acceptable to the City.
 - **Provider Selection.** Only those financial institutions with long-term ratings greater than or equal to that of the City, and short-term ratings of VMIG 1, A-1, or F1, by Moody’s Investors Service, Standard & Poor’s and Fitch IBCA, respectively, may be solicited.
 - **Selection Criteria.** The selection of LOC providers will be based on responses to a City-issued request for qualifications; criteria will include, but not be limited to, the following:
 - Ratings at least equal to or better than the financing issues’ underlying credit rating.
 - Evidence of ratings (including the market outlook of the LOC).
 - Trading value relative to other financial institutions.
 - Terms and conditions acceptable to the City; the City may provide a term sheet along with the request for qualifications to which the financial institution may make modifications.
 - Representative list of clients for whom the bank has provided credit facilities.
 - Fees, specifically, cost of LOC, draws, financial institution counsel and other administrative charges.

VII. Refinancing Outstanding Debt

The Director of Administrative Services shall have the responsibility to analyze outstanding bond issues for refunding opportunities that may be presented by underwriting and/or financial advisory firms. The Director of Administrative Services will consider the following issues when analyzing possible refunding opportunities:

- **Debt Service Savings.** The City establishes a guideline net present value savings threshold goal of three percent (3%) of the refunded bond principal amount. The net present value savings will be net of all costs related to the refinancing. The City will evaluate each refunding candidate on a case-by-case basis. In evaluating such refundings and the appropriateness of a 3% or higher refunding goal, the City will take into account whether the refunding will be current or advance, and if the latter, the period of time before the call date and the efficiency of the refunding escrow.

- **Restructuring.** The City will refund debt when in its best interest to do so. Refunding will include restructuring to meet unanticipated revenue expectations, achieve cost savings, mitigate irregular debt service payments, release reserve funds, or remove unduly restrictive bond covenants.
- **Term of Refunding Issues.** The City may refund bonds within the term of the originally issued debt. However, the City may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible. The City may also consider shortening the term of the originally issued debt to realize greater savings. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.
- **Escrow Structuring.** The City shall utilize the least costly securities available in structuring refunding escrows. The City will examine the viability of an economic versus legal defeasance on a net present value basis. In the case where open market securities are purchased, the City shall procure a minimum of 3 competitive bids from approved broker-dealers. Such securities must be more cost effective than State and Local Government Obligations (SLGS), and that the price paid for the securities must be reasonable within Federal guidelines. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the City from its own account.
- **Arbitrage.** The City shall take all necessary steps to optimize escrows and to avoid negative arbitrage on any refunding.

VIII. Interest Rate Risk Mitigation Policy (Swap Policy)

An interest rate swap is an agreement between two parties to exchange one stream of interest payments for another, over a set period of time. Swaps are derivative contracts and trade over-the-counter. Investment and commercial banks with strong credit ratings are swap market-makers, offering both fixed and floating-rate cash flows to their clients. By convention, each participant in a swap transaction is known by its relation to the fixed rate stream of payments. The party that elects to receive a fixed rate and pay floating is the “receiver” and the party that received floating in exchange for fixed is the “payer.” Both the receiver and payer are known as counterparties in the swap transaction.

- **Purpose.** The purposes for which the City may utilize rate risk mitigation products are specified in Section 5922(a) of the Government Code. As required by the Government Code, no local agency may enter into any contracts or arrangements unless its governing body first determines that the contract, arrangement or program of contracts is designed to reduce the amount or duration of payment, currency, rate, spread, or similar risk or result in a lower cost of borrowing when used in combination with the issuance of bonds or enhance the relationship between risk and return with respect to the investment or program of investment in connection with, or incident to, the contract or arrangement which is to be entered into.

The Debt Policy Committee will recommend the use of these products only in a manner consistent with this section. It is the policy of the City of Stockton to utilize such financial instruments to better manage its assets and liabilities. The City of Stockton may execute interest rate swaps if the transaction can be expected to result in the following:

1. Reduce exposure to changes in interest rates in the context of a particular financing or the overall asset/liability management of the City.
2. Result in a lower net cost of borrowing with respect to the City's debt.
3. Manage variable rate exposure consistent with prudent policies.

When the Director of Administration Services recommends the use of interest rate reduction products, the Debt Policy Committee will provide information to the Mayor and City Council necessary to make the determinations required by the Government Code.

- **No Speculation.** Interest rate risk mitigation products will not be used for speculative purposes.
- **Form of Swap Agreements.** Each interest rate swap executed by the City of Stockton shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement. The swap agreements between the City of Stockton and each qualified swap counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as the Debt Policy Committee deems necessary or desirable.
- **Methods to Solicit and Procure Interest Rate Swaps.** The City of Stockton shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. Qualified swap counterparties are selected by the City's Debt Policy Committee. Qualified swap counterparties, for swap agreements longer than five years, must be rated at least "Aa3" or "AA-", or equivalent by any two of the nationally recognized rating agencies (i.e. Moody's, Standard and Poor's, or Fitch); or have a "AAA" subsidiary as rated by at least one nationally recognized credit rating agency. Swap agreements with a duration of five years or less require qualified swap counterparties that are rated at least A, or equivalent by any two of the nationally recognized rating agencies ((i.e. Moody's, Standard and Poor's, or Fitch); or have a "AA" subsidiary as rated by at least one nationally recognized credit rating agency. In addition, the counterparty must have a demonstrated record of successfully executing swap transactions. Each counterparty shall have minimum capitalization of at least \$150 million.

The City of Stockton may negotiate or competitively bid an interest rate swap transaction based on a determination by the Debt Policy Committee of the method that will result in the lowest risk and cost. Considerations under which swaps are

procured on a negotiated basis include the following:

1. The existing market for the type of interest rate swap expected to be entered into.
2. The availability of counterparties for the type of swap.
3. The size of the swap.
4. The costs and expenses associated with a negotiated vs. competitive procurement.
5. The proprietary nature of the proposed transaction or application.

If the swap is competitively purchased, the City retains the right to determine the winning bidder based upon the most advantageous terms to the City, taking into consideration factors in addition to rate.

▪ **Termination Provisions**

Optional termination: All swap transactions shall contain provisions granting the City of Stockton the right to optionally terminate a swap agreement at any time over the term of the agreement. In general, exercising the right to optionally terminate an agreement produces a benefit to the City, either through receipt of a payment from a termination, or if a termination payment is made by the City of Stockton, in conjunction with a conversion to a more beneficial (desirable) debt obligation of the City as determined by the Debt Policy Committee. The Debt Policy Committee shall determine if it is financially advantageous for the City to terminate a swap agreement.

Mandatory Termination: A termination payment to or from the City of Stockton may be required in the event of termination of a swap agreement due to a default or a decrease in credit rating of either the City or the counterparty. It is the intent of the City of Stockton not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to making any such termination payment, the Debt Policy Committee shall evaluate whether it is financially advantageous for the City to obtain a replacement counterparty to avoid making such termination payment.

In the event of default by a counterparty whereby the City would be required to make a termination payment, the City will proceed as follows:

1. In order to mitigate the financial impact of making such payment at the time such payment is due; the City of Stockton will seek to replace the terms of the terminated transaction with a replacement counterparty. The new or replacement counterparty will make an upfront payment to the City of Stockton in an amount that would offset the payment obligation of the City to the original counterparty.
2. If a satisfactory agreement with a replacement counterparty is not reached,

the City of Stockton will be required to make a swap termination payment to the original defaulting counterparty. Funds for such payment shall be made from available monies.

- **Term and Notional Amount of Swap Agreement.** The City of Stockton shall determine the appropriate term for an interest rate swap agreement on a case by case basis. The slope of the swap curve, the marginal change in swap rates from year to year along the swap curve, the term of any associated debt obligation, and the impact that the term of the swap has on the overall exposure of the City shall be considered in determining the appropriate term of any swap agreement. In connection with the issuance or carrying of bonds, the term of a swap agreement between the City of Stockton and a qualified swap counterparty shall not extend beyond the final maturity date of existing debt of the City, or in the case of a refunding transaction, beyond the final maturity date of the refunding bonds.
- **Swap Counterparty Exposure Limits.** In order to diversify the City's counterparty risk, and to limit the City's credit exposure to any one counterparty, limits will be established for each counterparty based upon both the credit rating of the counterparty as well as the relative level of risk associated with each existing swap transaction. The risk measure will be calculated based upon the mark-to-market sensitivity of each transaction to an assumed shift in interest rates. Assuming a 25 basis point movement in the swap rate, the maximum net exposure (termination payment) per counterparty shall not exceed the following amounts:

<u>Credit Rating</u>	<u>25 Basis Point Shift in the Yield Curve</u>
Fully Collateralized	\$ 5,000,000
AAA	\$ 4,000,000
AA	\$ 3,000,000

The calculation of net interest rate sensitivity per counterparty will take into consideration multiple transactions, some of which may offset market interest rate risk thereby reducing overall exposure to the City. Additional exposure provisions are as follows:

1. The sum total notional amount per swap counterparty may not exceed 40 percent of the City's total bonded indebtedness.
2. The appropriate collateral amount will be determined on a case by case basis, and approved by the Debt Policy Committee.

If the sensitivity limit is exceeded by a counterparty, the City of Stockton shall conduct a review of the exposure sensitivity limit calculation of the counterparty.

The Debt Policy Committee shall evaluate appropriate strategies to mitigate this exposure.

- **Collateral Requirements.** As part of any swap agreement, the City of Stockton may require collateralization or other credit enhancement to secure any or all swap payment obligations. As appropriate, the Debt Policy Committee may require collateral or other credit enhancement to be posted by each swap counterparty under the following circumstances:
 1. Each counterparty to the City may be required to post collateral if the credit rating of the counterparty or parent falls below the “AA” category. Additional collateral for further decreases in credit ratings of each counterparty shall be posted by each counterparty in accordance with the provisions contained in the collateral support agreement to each swap agreement with the City of Stockton.
 2. If the rating of the counterparty is below investment grade, then the City shall retain the right to terminate the swap at market value, or assign the swap to a new counterparty, or such other remedy as the City determines is appropriate.
 3. Collateral shall consist of cash, non-callable direct obligations or obligations unconditionally guaranteed by the U.S. Treasury, or non-callable senior debt obligations of Freddie Mac, Fannie Mae or the Federal Home Loan Banks. The sum total notional amount per swap counterparty may not exceed 25 percent of the City’s total revenue bond indebtedness.
 4. Collateral shall be deposited with a third party trustee, or as mutually agreed upon between the City and each counterparty.
 5. A list of acceptable securities that may be posted as collateral and the valuation of such collateral will be determined and mutually agreed upon during negotiation of the swap agreement with each swap counterparty.
 6. The market value of the collateral shall be determined on a daily basis.
 7. The City of Stockton will determine reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
 8. The Debt Policy Committee shall determine on a case by case basis whether other forms of credit enhancement are more beneficial to the City of Stockton.
- **Reporting Requirements.** A written report providing the status of all interest rate swap agreements will be provided to City Council on a quarterly basis and shall include the following information:

1. Highlights of all material changes to swap agreements or new swap agreements entered into by the City since the last report.
 2. Market value of each of the City's interest rate swap agreements.
 3. The net impact to the City of a 25 basis point movement (up or down) with the appropriate swap index or curve.
 4. For each counterparty, the City of Stockton shall provide the total notional amount position, the average life of each swap agreement, the available capacity to enter into a swap transaction, and the remaining term of each swap agreement.
 5. The credit rating of each swap counterparty and credit enhancer insuring swap payment, if any.
 6. Actual collateral posting by swap counterparty, if any, per swap agreement and in total by swap counterparty.
 7. A summary of each swap agreement, including but not limited to the type of swap, the rates paid by the City and received by the City, and other terms.
 8. Information concerning any default by a swap counterparty to the City, and the results of the default, including but not limited to the financial impact to the City, if any.
 9. A summary of any planned swap transactions and the impact of such swap transactions on the City of Stockton.
 10. A summary of any swap agreements that were terminated.
- The Debt Policy Committee shall review the City's swap policy on an annual basis and recommend appropriate changes to the City Council.

IX. Methods of Issuance

The City will determine, on a case by case basis, whether to sell its bonds competitively or through negotiation.

- **Competitive Sale.** In a competitive sale, the City's bonds shall be awarded to the bidder providing the lowest true interest cost as long as the bid adheres to the requirements set forth in the official notice of sale.
- **Negotiated Sale.** The City recognizes that some securities are best sold through negotiation. In its consideration of a negotiated sale, the City shall assess the following circumstances:
 - Bonds issued as variable rate demand obligations.

- A complex structure which may require a strong pre-marketing effort.
- Size of the issue which may limit the number of potential bidders.
- Market volatility is such that the City would be better served by flexibility in timing its sale in changing interest rate environments.
- Other criteria to consider: the absence of investment grade rating of the bonds; timing considerations beyond “market volatility” (e.g., refundings),

X. Underwriter Selection

It is within the City’s best interest to be in a position to be able to react quickly and issue debt based on favorable market conditions. Therefore, the City will periodically issue a Request for Proposals to a number of underwriting firms, and through a thorough review and selection process will pre-qualify a number of underwriting firms for a pool from which underwriters will be selected for various financings. Firms from this pool may be selected to act as sole, senior or co-manager, or as a group member in a syndicate.

- **Underwriter’s Responsibilities.** The underwriter will be expected to assist in the development of a sound financial plan for the capital facility or infrastructure that is planned to be financed as necessary, and to underwrite the bonds to finance the project. Specific services, although not all inclusive, are listed below. Note that if the terms of the specific services differ from those described in a formal contract, the services as described in the contract shall prevail.
 - Meet with City staff, developers, members of the financial team and others as required, to become familiar with the Project.
 - Determine, with the assistance of City staff, the capital requirements for the Project.
 - Determine and recommend the means of financing which is the most cost effective in regard to net interest cost, annual debt service, market timing and other matters which affect the cost of the financing.
 - Either independently, or in conjunction with City's financial advisor, recommends alternative credit structures for the financing.
 - Prepare a written analysis to be presented to the City of the recommended structure, pricing and sizing of the issue, based on the then current market conditions. Modify said analysis to meet the changing conditions of the financial markets.
 - Prepare a time schedule for the financing, with each critical component or task identified with the operative date of occurrence. Modify such schedule as needed. The schedule will be circulated to all participants in the financing including City staff, financial advisor, the developer, if any, bond counsel, disclosure counsel, and the City Attorney's Office.

- Recommend and institute, with the City’s concurrence, a marketing plan for selling the financial instruments. Such plan may include distributing preliminary official statements to all individuals, broker-dealers and institutional investors targeting those most likely to purchase the instruments, and following up with telephone calls and other forms of communication.
- Coordinate the financing with the financial advisor, bond counsel and disclosure counsel regarding the legal requirements of the financing and the preparation and structure of documents, including but not limited to, the preliminary and final official statements.
- Conduct a pre-pricing conference call with City staff the day before the sale. The purpose is to discuss with staff coupon interest rates, prices and yields for the financial instruments to be issued, and to review the comparable sales provided by the underwriter for recently conducted sales of like issues.
- Purchase the bonds, subject to pertinent resolutions, the official statement, and all other necessary documents, approvals and proceedings governing such debt obligations having been determined by bond counsel, the City, financial advisor and underwriter to be satisfactory in all respects for financing purposes.
- Obtain CUSIP Numbers for the bonds, if required.
- Prepare a final pricing report which includes an analysis of the interest rates obtained compared to other comparable financings in the market at that time.

XI. Underwriter’s Compensation. See Exhibit ‘A’

XII. Bond Counsel Selection

The issuance of debt by the City will include a written opinion by legal counsel affirming that the City is authorized to issue the proposed debt, that the City has met all constitutional and statutory requirements necessary for issuance, and a determination of the proposed debt’s federal income tax status. The approving opinion and other documents relating to the issuance of debt will be prepared by counsel with extensive experience in public finance and tax issues.

In order to be able to react quickly and issue debt based on favorable market conditions, the City will periodically issue a Request for Proposals to a number of bond counsel firms, and through a thorough review and selection process will pre-qualify a number of bond counsel firms for a pool from which bond counsel will be selected for various financings. Bond counsel will be selected by the City Attorney’s Office and Debt Policy Committee in consultation with the City Manager.

- **Bond Counsel Responsibilities.** The services to be provided by bond counsel will include, but not be limited to, those listed below. Note that if the terms of the

specific services differ from those described in a formal contract, the services as described in the contract shall prevail.

- Provide an objective legal opinion with respect to the authorization and issuance of local agency debt obligations and whether interest paid is tax-exempt under federal and/or state laws and regulations.
- Research applicable law; preparing documents; consulting with City staff and the financial team; reviewing proceedings; and performing additional duties as necessary to render the opinion.
- Provide continuing legal advice regarding any actions necessary to ensure that interest will continue to be tax-exempt.
- Prepare legal documents for the financing, including closing documents and transcripts.
- Participate, when requested, in activities associated with rating agency reviews.
- Offer continuing legal advice, as needed, on issues related to the sale and the trustee administration of City's obligations.
- In cases where a separate disclosure counsel is not retained by the City, bond counsel will provide the City with a "10b-5 Opinion" with respect to the preliminary and final official statements.
- Provide a legal opinion with respect to the authorization and issuance of the debt obligations and whether interest paid is tax-exempt.
- Attend City Council meetings when the debt obligation for which counsel is providing services is being considered. Participate in staff meetings, including post issuance reviews, as requested, relating to the issuance of debt.

- **Bond Counsel Compensation.** See Exhibit 'A'

XIII. Consultants

- **Financial Advisor.** The City may select a financial advisor (or advisors) to assist in its debt issuance and debt administration processes. Selection of the City's financial advisor(s) shall be based on, but not limited to, the following criteria:
 - Experience in providing consulting services to complex issuers.
 - Knowledge and experience in structuring and analyzing complex issues.
 - Experience and reputation of assigned personnel.
 - Fees and expenses.
- **Financial Advisor Services.** Financial advisor services provided to the City shall include, but shall not be limited to those listed below. Note that if the terms of the

specific services differ from those described in a formal contract, the services as described in the contract prevail.

- Take primary responsibility for review of the quantitative analysis of the cash flows provided by the underwriter. Prepare reports matching all calculations for bond sizing, debt service schedules, savings calculations, bond calls, escrow calculations and cash flows on the project. Prepare any other cash flow schedules as requested by the City.
- Provide all cash flow schedules in a reasonable and timely fashion to all Finance Team members including but not limited to City staff, bond counsel, underwriter, and disclosure counsel. In addition, make all schedules, in presentation form, available to rating agencies and bond insurers as requested by the City.
- Prepare the detailed costs of issuance, review the gross spread (underwriter's discount) and review all funds available as contributions to any refinancing.
- Assist the City in the design and implementation of a credit strategy, including preparation of presentations to credit rating agencies and bond insurers or other credit providers, development of requests for proposals for municipal bond insurance, surety bonds and/or letters of credit, and the analysis of the economic efficiency of any proposed credit enhancement.
- In the case of a competitive sale of bonds, advise the City on the appropriate terms and parameters for the Notice of Sale and market timing for the receipt of bids.
- Be available at reasonable times for consultation to render advice regarding all financial aspects of the project as may be requested.
- Attend meetings and make presentations as requested. Prepare graphs, charts, etc. for staff presentations as needed.
- Review and comment on all legal documents including, but not limited to, the preliminary and final official statements, resolutions, loan agreements, indenture and the fiscal agent agreement.
- Conduct pre-pricing, pricing and post-pricing conference calls with City Staff and underwriter reviewing market conditions, comparable sales, fees related to the refinancing and final sale results.
- Provide City staff with recent comparable sales from similar projects including information related to that project and the final sale coupons and yields.
- Be responsible and readily available to City staff (or designee) for the handling and answering of any and all questions, inquiries, and correspondence from interested persons referred to the Financial Advisor by City staff (or designee)

regarding the services provided by the Financial Advisor.

- **Financial Advisor Compensation.** See Exhibit 'A'
- **Disclosure Counsel.** In any sale of City debt in which legal counsel is required to represent the City, the City shall appoint a disclosure counsel. The scope of duties will include, but not be limited to, the following:
 - Prepare the preliminary and final official statements.
 - Provide a "10b-5 Opinion" with respect to the preliminary and final official statements.
 - Prepare all documents and materials necessary to comply with all applicable "continuing disclosure" requirements for the transaction.
 - Review, as necessary, applicable law and pertinent documents.
 - Attend City Council meetings when the debt obligation for which counsel is providing services is being considered. Participate in staff meetings, including post issuance reviews, as requested, relating to the issuance of debt.
- **Disclosure Counsel Compensation.** See Exhibit 'A'

XIV. Market and Investor Relationships

- **Rating Agencies and Investors.** The Director of Administrative Services shall be responsible for maintaining the City's relationships with Moody's Investors Service, Standard & Poor's and Fitch IBCA. The City may, from time to time, choose to deal with only one or two of these agencies as circumstances dictate. In addition to general communication, the Director of Administrative Services shall: (1) communicate with credit analysts at least once each fiscal year, and (2) prior to each competitive or negotiated sale, offer conference calls and meetings with agency analysts in connection with the planned sale.
- **City Council Communication.** As appropriate, the Director of Administrative Services shall provide feedback to the City Manager from rating agencies and/or investors regarding the City's financial strengths and weaknesses and recommendations for addressing any weaknesses.
- **Continuing Disclosure.** The City shall remain in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders by March 31 each year.
- **Rebate Reporting.** The use of bond proceeds and their investments must be monitored to ensure compliance with arbitrage restrictions as contained in the Federal Tax Code. Existing regulations require that issuers calculate annual rebates,

due for interest earnings on bond proceeds in excess of the interest rate on the bonds if any, with rebate, if due, paid every five years. Therefore, the Director of Administrative Services shall ensure that proceeds and investments are tracked in a manner which facilitates accurate calculation, that calculations are completed, and rebates, if any, are made in a timely manner.

- **Conduit Financings.** The applicant must go through any Joint Powers Authority (JPA) of which the City is a member. Conduits, or Tax and Equity Fiscal Responsibility Act of 1982 (TEFRA), are (non-city) debt, therefore the City does not act as an issuer for conduit debt. The sole purpose of the JPA is to finance projects that promote economic development through the issuance of bonds.

Before bonds are issued, the federal tax laws under the TEFRA and Section 147 (f) of the Internal Revenue Code require the JPA member (City of Stockton) to 1) conduct a public hearing and 2) approve the JPA's issuance of indebtedness.

XV. Glossary for definition of terms www.investinginbonds.com

EXHIBIT 'A'

COMPENSATION SCHEDULE

- **Underwriter's Compensation.** An underwriter shall be entitled to an Underwriter's Discount to be negotiated with the City prior to initiating underwriting services. Said Underwriter's Discount shall not exceed those amounts set forth below in conjunction with the monetary value of the issuance.

– **Non-Rated Issues:**

<u>Maximum Fee per \$1,000 Bond</u>	<u>Bond Issue Size</u>
\$15.00 of the portion	up to \$5,000,000
plus \$12.50 of the portion	from \$5,000,001 to \$10,000,000
plus \$11.50 of the portion	from \$10,000,001 to \$20,000,000
plus \$11.00 of the portion	over \$20,000,001

– **Rated or Insured Issues:**

Underwriter compensation on rated or insured issues will be set in collaboration with the financial advisor and will be based on the prevailing market for fees paid for in comparable issue types, complexities and size.

Notwithstanding the above, an underwriter shall be entitled to a minimum fee of \$22,500 for any issue for which underwriter has been engaged to provide underwriting services.

The Underwriter's Discount allowed on each issue shall include management fees, takedown, underwriter's risk, and expenses of sale, including but not limited to, underwriter's counsel, travel and out-of-pocket expenses, computer and modeling, charges from the California Debt Advisory Commission (CDIAC), assignment of CUSIPS, day loan charges, and other usual and customary costs incurred by the underwriter.

– All fees are contingent upon the successful completion of the City's financing.

- **Bond Counsel Compensation.** Compensation will be based on the following terms.

– The fee for each financing will be computed on the basis of a minimum fee of twenty thousand dollars (\$20,000) plus one-quarter of one percent (.25%) of the

first ten million dollars (\$10,000,000) of bonds issued plus one tenth of one percent (.1%) of any principal amount of bonds issued in excess of ten million dollars (\$10,000,000) up to \$20,000,000 plus seven and one half of one percent (.075%) of any principal amount of bonds issued in excess of twenty million dollars (\$20,000,000) up to \$30,000,000. For amounts in excess of \$30,000,000, the City shall negotiate an acceptable fee with the qualified firm of its choice. In the event that an agreement is not reached between the City and that qualified firm, the City shall negotiate with a different qualified firm. Such selection process will continue until a qualified firm accepts the City's proposed fee.

- Reimbursement for actual out-of-pocket expenses shall not exceed 10% of the fee. The qualified firm must submit invoices for such expenses satisfactory to the City prior to reimbursement of any out-of-pocket expense.
- All fees are contingent upon the successful completion of the City's financing.
- **Financial Advisor Compensation.** Financial Advisor compensation shall be negotiated on a case-by-case basis not to exceed the fees paid to the Bond Counsel. The Financial Advisor should be compensated based on the following terms.
 - The fee for each financing will be negotiated based on the complexity and size of the specific transaction.
 - All fees paid to the Financial Advisor are inclusive of out-of-pocket expenses.
 - All fees are contingent upon the successful completion of the City's financing.
- **Disclosure Counsel Compensation.** The fee paid to disclosure counsel is 60% of the fee paid to bond counsel. Other terms of compensation include:
 - Reimbursement for actual out-of-pocket expenses shall not exceed 10% of the fee. The qualified firm must submit invoices for such expenses satisfactory to the City prior to reimbursement of any out-of-pocket expense.
 - All fees are contingent upon the successful completion of the City's financing.