Agenda Report

August 9, 2010

TO: Honorable Mayor and City Council

Through: Finance Committee

FROM: Finance Department

SUBJECT: Adoption of Debt Management Policy and Overview of the City's Debt Profile.

RECOMMENDATION:

It is recommended that the City Council adopt the proposed Debt Management Policy.

BACKGROUND:

Following discussion by the Finance Committee on August 2, 2010 they recommended that the discussion be continued to August 9' 2010 for additional deliberation. This report provides a general description of the City's debt policy, debt management goals and objectives and highlights some important concepts and topics related to debt issuance and debt management. The later part of the report includes a discussion of the City's debt profile and debt capacity supplemented by Attachment A which includes a summary of the City's outstanding General Fund debt, statistics on comparable California cities and Pasadena's credit strength and challenges.

The City's overriding goal in issuing debt is to respond to and provide for the needs of its citizens while maintaining fiscal responsibility. The City issues and administers debt using business prudence, diligence, and industry best practices. One industry best practice is the adoption of a debt management policy which establishes and documents the City's goals and policies for the use of debt to fund various needs of the City.

Debt can be an equitable means of financing projects that for timing, cost, or other reasons can be advantageous to the City. An analysis should be completed before any debt is issued to determine if "pay-as-you-go" method of completing projects is more advantageous. The "pay-as-you-go" method tends to be more difficult for funding of large capital projects unless a large revenue stream can be identified that meets project completion timing requirements. However, if timing can be extended and a revenue stream identified, the funds should be set aside and invested to generate the necessary funding to complete the project. This will in most cases result in a lower project cost than debt funded projects. Considerations such as size of the project, useful life of the project, opportunity cost, cost of money, type of project, etc. all need to be taken into account when determining which funding method is more advantageous. A documented debt management policy helps to standardize and focus the decision making process for issuing debt.

The attached recommended debt policy is designed to:

- Establish parameters for issuing and managing debt;
- Provide guidance to decision makers related to debt affordability standards;
- Document the objectives to be achieved by staff, both pre- and post- issuance;
- Promote objectivity in the decision-making process; and
- Facilitate the actual financing process by establishing important policy decisions in advance.

An important goal is the maintenance of Pasadena's high credit ratings by the primary bond rating agencies, which include Fitch, Moody's and Standard and Poor's (S & P). Pasadena currently maintains a AAA rating on its general obligation bonds from Fitch and AAA rating from S&P. These are the highest ratings available. These high ratings reflect upon the general reputation of the City and its management and also add to Pasadena's reputation as a world-class city. By maintaining high credit ratings, when Pasadena decides to issue debt, it can be issued at lower interest rates as compared to entities with lower ratings. This minimizes cost of debt for Pasadena taxpayers.

The City will also seek to minimize borrowing costs by taking advantage of favorable economic conditions. Timing debt issuance to accommodate market interest rates and investor sentiment is also an important means of minimizing the cost of debt. To accomplish this, the City will seek input on market conditions from financial consultants who closely monitor the financial markets.

The City will adhere to the following legal requirements for the issuance of public debt:

- The state law, which authorizes the issuance of the debt;
- The federal and state tax laws, which govern the eligibility of the debt for tax-exempt status; and
- The federal and state securities law, which govern disclosure, sale and trading of the debt.

The City is active in the municipal bond market and has issued various types of bonds. The City has issued numerous Certificates of Participations, Lease Revenue Bonds, Tax Allocation Bonds, Electric Revenue Bonds and Water Revenue Bonds. The City has also issued Special Assessment District Bonds, Community Facilities District bonds and Housing Revenue Bonds. The only General Obligations Bond (GO Bond) the City has issued was in 1987 to finance the policy building. The police building GO bond was paid off in 2007. The debt policy authorizes the issuance of these various types of bonds and provides a description of each type.

The City's Debt Policy grants the Director of Finance the authority to select the financing team, coordinate the administration and issuance of debt, communicate with the rating agencies and fulfill all the pre-issuance and post-issuance disclosure information. The financing team typically includes a bond counsel, an underwriter's counsel, an underwriter(s), a financial advisor, and a trustee or paying agent plus other required service providers. Once the team completes all the work and the required financing documents, the Director of Finance determines the method of sale of the debt. With the exception of the Utility Revenue Bonds which are required to be sold on a competitive basis, the Debt Policy provides the Director of Finance the authority to determine the best method of sale of the City's different types of bonds (negotiated, competitive or privately placed).

The Finance Director conducts periodic reviews of the City's outstanding debt to determine refunding opportunities and determines the net economic benefit of each refunding proposal. The City may refund a bond if the net present value savings equal or exceed 3%. The City can proceed with a current refunding of an outstanding issue or an advanced refunding. Refundings with negative savings will not be considered unless there is a compelling public policy objective or the restructuring of the debt is in the City's overall best financial interest.

The City shall seek to obtain credit enhancement when such enhancement prove to be cost effective. The Director of Finance will review the cost benefit analysis of such credit enhancement and recommend it if the credit enhancement meets the City's debt financing goals and objectives. The City's debt Policy also includes in Appendix A a derivative policy. The City has utilized derivative products as a tool to enable the City to achieve a lower net borrowing cost on certain debt. The derivative policy was developed as best practice and periodically reviewed with the rating agencies.

Pasadena Debt Profile

The following discussion of the City's debt profile focuses only on the City's General Fund credit and does not include the Power Fund, the Water Fund or any of the City's Redevelopment Project Funds. As previously stated, the City is an active issuer of various municipal bonds including but not limited to Electric Revenue Bonds, Water Revenue Bonds and Tax Allocation Bonds. As of June 30, 2010 the City had an outstanding $155.5 million Electric Revenue Bonds, $57.14 million Water Revenue Bonds and $6.4 million Tax Allocation Bonds. However, the focus in this report, as discussed in the following paragraphs, addresses only General Fund debt and bonds guaranteed and paid by General Fund revenues.

In accordance with section 910 of the City of Pasadena Charter, the amount of general obligation bonds (GO bonds) the City may issue is limited to 15% of the City's real and personal property assessed value. Within the meaning of this section, indebtedness means bonded indebtedness of the City payable from the proceeds of taxes levied upon taxable property in the City. For Pasadena this would equate to $2.9 Billion based on the City's FY 2009/10 assessed value. General obligation bonds require two third majority vote, under State law, and currently the City has no outstanding GO bonds.

The City has a total of $478 million of outstanding certificates of participation (COPs), lease revenue bonds (LRBs) and pension obligation bonds (POBs) that are General Fund debt obligations but not subject to the debt limitation. There is no legal or statutory limitation on the amount of COPs, LRBs, or POBs the City can issue. This doesn't mean that Pasadena could easily issue debt at anytime. Numerous factors such as ability to pay and the market's belief in the strength of the revenue sources pledged to repay the debt dictate how much debt the City can actually issue. This is referred to as the City's debt capacity. Attachment A reflects a breakdown of the City's outstanding General Fund backed debt as of July 1, 2010. Approximately 74% of Pasadena's current General Fund backed debt is self supporting. This means that other specific revenue sources have been identified to pay the debt service. The General Fund's credit support created a stronger credit position and allowed the debt to be issued at lower interest rates. However, if the other specific revenues are inadequate to pay debt service, funds from the General Fund would have to be used.

Determining what the City's debt capacity is at any point in time is difficult. It depends on a number of factors including market conditions, a high undesignated fund balance in the General Fund, high cash balances, strong financial policies, management experience and expertise, new or existing revenues available to support additional debt, etc. Staff, working with financial consultants, performed an analysis to determine what Pasadena's debt capacity might be based on those factors previously mentioned and other factors. Based on that analysis and assuming the City finds new sources of revenues to pay for debt service, it is the City's financial consultants' estimate that Pasadena's debt capacity is approximately $75-$100 million for governmental purposes without impacting the City's AAA rating status. If the City decides to fund the Unfunded Actuarial Accrued Liability in its Fire and Police Retirement System by issuing pension obligation bonds, then the City's bonding capacity will be reduced accordingly.

This capacity estimate is based on Pasadena's direct General Fund backed debt excluding that which is self supporting such as the Rose Bowl financing or the Conference Center bonds. Using this same analysis, the City's current direct General Fund debt per capita (excluding self-supporting debt) is $900 as compared to $1,241, the average of surveyed AAA rated group of cities which include Beverly Hills, Santa Monica, San Jose, Glendale and Burbank. However, when the General Fund direct debt is combined with the self supporting debt, then the City's debt leverage is above the average of the AAA rated cities in California.

For self supporting debt such as the proposed Rose Bowl renovation financing, it is the City's financial advisors' opinion that the probability of a downgrade as a result of the City extending credit on the Rose Bowl financing is low given the proposed structuring of the financing.

COUNCIL POLICY CONSIDERATION

This action supports the City Council Strategic Goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

Adoption of staff's recommended debt management policy evidences the City's commitment to adhere to prudent debt management policies and procedures.

Respectfully submitted;

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