

City of Pasadena, California

DEBT POLICY

*Department of Finance
Treasury Division*

Table of Contents

INTRODUCTION.....	1
<hr/>	
DEBT MANAGEMENT POLICY OVERVIEW.....	2
<hr/>	
CHAPTER I	
CREDITWORTHINESS OBJECTIVES.....	4
<i>1.1 Credit Ratings</i> <i>1.2 Rating Agency Relationships</i> <i>1.3 Use of Rating Agencies</i> <i>1.4 Minimum Long-Term Rating Requirements</i> <i>1.5 Financial Disclosure</i> <i>1.6 Enhancing Creditworthiness</i> <i>1.7 Debt Limits</i>	
<hr/>	
CHAPTER II	
PURPOSE & NEED FOR DEBT.....	7
<i>2.1 Purpose of Debt</i> <i>2.2 Capital Financing</i> <i>2.3 Asset Life</i> <i>2.4 Competing Projects</i> <i>2.5 Nature of Project and Use of Funds</i> <i>2.6 Cost-Benefit Analysis of Project</i> <i>2.7 Expenditure Plan and Sources of Debt Servicing</i>	
<hr/>	
CHAPTER III	
COMPREHENSIVE CAPITAL PLANNING & FINANCING SYSTEM.....	9
<i>3.1 Capital Planning and Financing System</i> <i>3.2 Financing Priorities</i> <i>3.3 Funding of Capital Outlays</i> <i>3.4 Maintenance, Replacement and Renewal</i> <i>3.5 Debt Authorization</i> <i>3.6 Investment of Bond Proceeds</i> <i>3.7 Internal Control</i>	
<hr/>	
CHAPTER IV	
AFFORDABILITY TARGETS.....	11
<i>4.1 General Obligation Bonds</i> <i>4.2 Revenue Bonds</i> <i>4.3 Tax Allocation Bonds</i>	
<hr/>	

**CHAPTER V
LIMITATIONS ON CITY INDEBTEDNESS..... 13**

- 5.1 Legal Limits Set by State and City Limits*
- 5.2 Non-Restrictive Debt*

**CHAPTER VI
TYPES OF DEBT..... 13**

- 6.1 Term and Serial Bonds*
- 6.2 Utility Revenue Bonds*
- 6.3 Certificate of Participation*
- 6.4 General Obligation Bonds*
- 6.5 Tax Allocation Bonds*
- 6.6 Special District Tax Bonds*
- 6.7 Joint Ventures Arrangements with Other Governmental Agencies*
- 6.8 Special Assessment Bonds*
- 6.9 Tax Revenue Anticipation Notes*
- 6.10 Lines and Letters of Credit*
- 6.11 Bond Anticipation Notes*
- 6.12 Tax Exempt Commercial Paper*
- 6.13 Multifamily Housing Revenue Bonds and Single Family Housing Revenue Bonds*

**CHAPTER VII
STRUCTURE & TERM OF CITY INDEBTEDNESS..... 19**

- 7.1 Length of Debt*
- 7.2 Rapidity of Debt Repayment*
- 7.3 Backloading*
- 7.4 Use of Variable-Rate Securities*
- 7.5 Debt Security Reserve Fund*
- 7.6 Capitalized Interest*
- 7.7 Sinking Funds*

**CHAPTER VIII
METHOD OF ISSUANCE & SALE..... 22**

- 8.1 Authority and Responsibility*
- 8.2 Professional Services Support*
- 8.3 Debt Instrument Rating*
- 8.4 Disclosure Requirements*
- 8.5 Inter-government Coordination*
- 8.6 Costs and Fees*
- 8.7 Sale Process*
- 8.8 Competitive Sale*
- 8.9 Bidding Parameters*
- 8.10 Negotiated Sale*
- 8.11 Underwriters*
- 8.12 Private Placement*

CHAPTER IX	
SELECTION OF FINANCE CONSULTANTS & SERVICE PROVIDERS.....	26
<i>9.1 Authority and Responsibility</i>	
<i>9.2 Bond Counsel</i>	
<i>9.3 Underwriters</i>	
<i>9.4 Financial Advisor</i>	
<i>9.5 Paying Agent</i>	
<i>9.6 Other Service Providers</i>	
<i>9.7 Compensation for Services</i>	

CHAPTER X	
REFUNDING OF CITY INDEBTEDNESS.....	29
<i>10.1 Call Options</i>	
<i>10.2 Advance Refunding</i>	
<i>10.3 Current Refunding</i>	
<i>10.4 Restructuring of Debt</i>	
<i>10.5 Open Market Purchase of City Securities</i>	

CHAPTER XI	
CREDIT ENHANCEMENT, DERIVATIVES & CONDUIT FINANCINGS.....	31
<i>11.1 Credit Enhancement</i>	
<i>11.2 Derivative Products</i>	
<i>11.3 Conduit Financings</i>	

CHAPTER XII	
REVIEW OF FINANCING PROPOSALS.....	32
<i>12.1 Authority and Responsibility</i>	

CHAPTER XIII
REPORTING REQUIREMENTS..... 32

- 13.1 Annual Audit of the City*
- 13.2 Arbitrage Compliance*

APPENDIX A
DERIVATIVES POLICY 34

- 14.1 Overview*
- 14.2 Acceptable Derivatives Objectives*
- 14.3 Prohibited Agreements*
- 14.4 Permitted investments*
- 14.5 Derivative Approval Procedures*
- 14.6 Risk/Benefit Analysis Report*
- 14.7 Methods of Soliciting and procuring Derivatives*
- 14.8 Form of Swap Agreements*
- 14.9 Minimum Counterparty Requirements*
- 14.10 Standard terms for derivatives*
- 14.11 Monitoring and Reporting*
- 14.12 Swap Counterparty Termination Exposure Limits*
- 14.13 Disclosure*
- 14.14 Dodd-Frank Compliance*

APPENDIX B
BASIC LEGAL DOCUMENTS..... 44

- 15.1 Indenture*
- 15.2 Loan Agreement*
- 15.3 Authorizing Resolution(s)*
- 15.4 Bond Purchase Agreement*
- 15.5 Official Statement*
- 15.6 Continuing Disclosure Agreement*
- 15.7 Reimbursement Agreement*
- 15.8 Tax Certificate*
- 15.9 Closing Documents*

INTRODUCTION

The following policies are enacted in an effort to standardize and rationalize the issuance and management of debt by the City of Pasadena and comply with existing law. The primary objective of the debt policy is to establish conditions for the use of debt and to create procedures and policies that minimize the City's debt service and issuance costs, retain the highest practical credit rating, and maintain full and complete financial disclosure and reporting.

Regular, updated debt policies are an important tool in ensuring the use of the City's resources to meet its commitments in providing the required services to the citizens of Pasadena, and to maintain sound financial management practices. Therefore, these policies are guidelines for general use and allow for exceptions in extraordinary conditions.

OVERVIEW

DEBT MANAGEMENT POLICY

The City's overriding goal in issuing debt is to respond to and provide for the needs of its citizens while maintaining its fiscal responsibilities. The City executes debt instruments, administers City-held debt proceeds, and makes debt service payments acting with prudence, diligence, and attention to prevailing economic conditions. This policy documents the City's goals for the use of debt instruments and provides guidelines for the use of debt for financing City needs.

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 City's 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 of the City is to maintain Pasadena's high credit ratings by the primary bond rating services: Fitch, Moody's, and Standard and Poor's. Pasadena's ratings reflect upon the general reputation of the City and its management. They also add to Pasadena's reputation as a world-class city. By maintaining high credit ratings, Pasadena can issue its debt at lower interest rates as compared to entities with lower ratings.

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 an important means of minimizing the cost of debt and the tax burden on the citizens of Pasadena. 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:

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

CHAPTER I

CREDITWORTHINESS OBJECTIVES

1.1 Credit Ratings

The City of Pasadena seeks to maintain the highest possible credit ratings for all categories of short- and long-term debt that can be achieved without compromising delivery of basic City services and achievement of adopted City policy objectives. The City recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. Nevertheless, the City is committed to ensuring that actions within its control are prudent. By maintaining high credit ratings, Pasadena can issue its debt at lower interest rates as compared to entities with lower ratings. Also, the ratings reflect upon the general reputation of the City and its management.

Each proposal for additional debt will be analyzed for its impact upon the City's debt rating. The major source of risk considered by the rating services is the stability and reliability of the revenue sources to service the debt. Projects with volatile or risky debt repayment streams that may adversely impact the City's high rating will be avoided where possible.

1.2 Rating Agency Relationships

The Director of Finance shall be responsible for maintaining relationships with the rating agencies that currently assign ratings to the City's various debt obligations. This effort shall include providing periodic updates, both formal and informal, on the City's general financial condition and coordinating meetings and presentations in conjunction with a new debt issuance.

1.3 Use of Rating Agencies

The Director of Finance 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.

1.4 Minimum Long-Term Rating Requirements

The City's minimum rating requirement for its direct, long-term, debt obligations is a rating of "A+" or higher. If such a debt obligation cannot meet this requirement based on its underlying credit strength, then credit enhancement shall be sought to ensure that the minimum rating is achieved. Obligations whose ratings would fall below the minimum rating requirement may be issued without a rating, if credit enhancement is unavailable or if the Director of Finance determines that the cost of credit enhancement is uneconomic.

A lower rating standard may be accepted for indirect or conduit obligations, subject to the approval of the Director of Finance.

1.5 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.

The City Treasurer shall be responsible for providing ongoing disclosure information to established national information repositories and for maintaining compliance with disclosure standards promulgated by state and national regulatory bodies. The City may also employ the services of firms that improve the availability of or supplement the City's NRMSIR filings.

Official statements accompanying debt issues, Comprehensive Annual Financial Reports, and continuous disclosure statements will meet (at a minimum), the standards articulated by the Municipal Standards Rulemaking Board (MSRB), the Government Accounting Standards Board (GASB), the National Federation of Municipal Analysts, the Securities and Exchange Commission (SEC), and Generally Accepted Accounting Principles (GAAP).

1.6 Enhancing Creditworthiness

To enhance creditworthiness and prudent financial management, the City of Pasadena is committed to systematic capital planning, interdepartmental cooperation and coordination, and long-term financial planning. Evidence of this commitment to systematic capital planning will be demonstrated through annual preparation of a rolling Five-Year Capital Improvement Program (CIP) and annual appropriation for current year projects.

1.7 Debt Limits

The City will keep outstanding debt within the limits prescribed by State statute, City Charter, and at levels consistent with its creditworthiness objectives.

CHAPTER II

PURPOSE AND NEED FOR DEBT

2.1 Purpose of Debt

The City may finance acquisition or construction of projects and capital assets through the issuance and sale of municipal securities. The issuance of debt to fund operating deficits is not permitted. The proceeds of City debt obligations will be used for the cost of such acquisition or construction. A prerequisite for the approval of a project for funding by debt is that it satisfies needs of the City of Pasadena, as determined by City Council.

2.2 Capital Financing

The City normally will initially rely on internally generated funds and/or grants and contributions from other governments to finance its capital needs. Debt will be issued for a capital project only in the case of emergency or when it is an appropriate means to achieve a fair allocation of costs between current and future beneficiaries. Debt shall not, in general, be used for projects solely because insufficient funds are budgeted at the time of acquisition or construction.

2.3 Asset Life

The City will consider long-term financing for the acquisition, maintenance, replacement, or expansion of physical assets (including land) only if they have a useful life of at least five years. Debt will be used only to finance capital projects and equipment, except in cases of emergency. City debt will not be issued for periods exceeding the useful life or average useful lives of the project or projects to be financed.

2.4 Competing Projects

Competing projects requesting funds will be evaluated according to priorities established by the City Council. In the selection of the projects to be funded, a balance will be established between the projects' abilities to meet the City's priorities and the financial requirements of the projects. For each project, the following information is necessary to assess the approvability of the project and its funding with debt:

- Nature of Project and Use of Funds
- Cost-Benefit Analysis of Project
- Expenditure Plan and Sources of Debt Servicing

2.5 Nature of Project and Use of Funds

For each project for which the debt is proposed, the nature of the project, as well as the intended use of the debt proceeds, will be described.

2.6 Cost-Benefit Analysis of Project

The benefits of a proposed project will be defined and, where appropriate, quantified in monetary terms. The sources and uses of funds will be identified and estimated. Where revenues are part of the benefits, all assumptions made in deriving the revenues will be documented. The validity of the assumptions and the risk associated with the revenue streams will be assessed. The costs of the project will be estimated, with the basis of estimates documented and the risk associated with the estimates assessed. Where general fund monies are proposed, the impact upon budgets and taxes will be assessed.

2.7 Expenditure Plan and Sources of Debt Servicing

A detailed plan for the funds expenditure and debt repayment will be developed for each project. The plan will demonstrate the timely matching of funds availability with project expenditures and that debt service will commence with the flow of revenues needed to pay interest and principal on the debt. The basis of estimates for the project cost expenditure plan and the basis of revenue cash flow estimates will be documented and the risk associated with these revenue streams will be analyzed.

CHAPTER III

COMPREHENSIVE CAPITAL PLANNING AND FINANCING SYSTEM

3.1 Capital Planning and Financing System

The aggregate cost of desired capital projects generally exceeds available funds. The capital planning process will prioritize projects and identify the funding needs. The debt management process will determine 1) the availability of funds which can be raised through debt, based upon the debt limit; 2) the totality of projects that can be accomplished; and when they will commence. Close coordination of capital planning and debt management will ensure that Pasadena citizens will achieve maximum benefit from the limited capital funds and that the potential for inappropriate spending and waste will be minimized. This coordinated program will be referred to as the Capital Improvement Program.

The City shall develop a system for use in preparing a multi-year Capital Improvement Program to be considered and adopted by the City Council as part of the City's budget process. Individual departments and agencies shall prepare multi-year capital plans. Coordination and preparation of the City-wide Capital Improvement Program shall reside with the Departments of Finance and Public Works. The Program shall incorporate the upcoming five fiscal years and shall be updated periodically. The Program shall contain a comprehensive description of the sources of project funds, timing of capital projects for future operating and capital budgets, financing arrangements, revenue projections and debt servicing. The Program shall ensure that the planned financings conform with policy targets regarding:

- Magnitude and composition of the City's indebtedness, and
- Economic and fiscal resources of the City to bear such indebtedness over the next five years.

Affordability impacts of the Program shall be evaluated in consultation with the various City Departments. Such planning will consider a long-term horizon so that project priorities and future commitment of funds are visible for the management decisions and public comment.

3.2 Financing Priorities

It shall be the responsibility of the Director of Finance, within the context of the Capital Improvement Program, to oversee and coordinate the timing, process of issuance, and marketing of the City's borrowing and capital funding activities required in support of the Program. In this capacity, the Director of Finance shall make recommendations to the City Council regarding necessary and desirable actions and shall keep it informed through regular and special reports as to the progress and results of current-year activities under the Program.

3.3 Funding of Capital Outlays

As part of its capital financing philosophy, the City shall make contributions from its own current revenues when available, or from outside funding sources, such as state or federal grants, to finance capital projects. The Department of Finance will have the responsibility to evaluate and recommend the funding method of each capital project.

3.4 Maintenance, Replacement and Renewal

Consistent with its philosophy of keeping its capital facilities and infrastructure systems in good repair and to maximize the capital stock's useful life, the City should set aside sufficient current revenues to finance ongoing maintenance needs and to provide reserves for periodic replacement and renewal.

3.5 Debt Authorization

All proposed debt financings of \$1 million individually or in aggregate per the same project shall be presented to the Finance Committee and approved by the City Council. Projects under \$1 million will be presented directly to City Council.

3.6 Investment of Bond Proceeds

The proceeds of the bond sales will be invested until used for the intended project in order to maximize utilization of the public funds. The investments will be made to obtain the highest level of safety. Pasadena's Statement of Investment Policy and the bond indentures should be referred to for more details on objectives and criteria for investment of bond proceeds. All bond proceeds will be invested by the City Treasurer in a manner to avoid, if possible, and minimize any potential negative arbitrage over the life of the bond issue.

3.7 Internal Control

The City shall be vigilant in using bond proceeds in accordance with the stated purpose at the time that such debt was issued. Whenever reasonably possible, proceeds of debt will be held by a third-party trustee and the City will submit written requisitions for such proceeds. The city will submit a requisition only after obtaining the signature of the City Manager, the Director of Finance or the City Treasurer. For bond proceeds held in the City Treasury, each withdrawal shall be submitted in writing and approved by the authorized personnel in accordance with the City's cash disbursement policy, and shall be recorded and filed.

CHAPTER IV

AFFORDABILITY TARGETS

Given the significant restrictions in California on local agency revenue sources, especially those imposed under Proposition 218, the City is aware of the need to gauge the effect of ongoing debt service on its budgets and fiscal priorities over time. Therefore, the City will consider generally accepted debt affordability standards in evaluating when, why and how much debt should be issued. These standards can lead to a debt affordability plan that keeps debt levels within acceptable ranges.

4.1 Affordability Targets for General Obligation Bonds

The City shall not assume more tax-supported general-purpose debt than it retires each year without conducting an objective analysis as to the community's ability to assume and support additional debt service payments. The City shall use an objective analytical approach to determine whether it can afford to assume the new debt. This process shall compare generally accepted measures of affordability to the current values for the City. These measures shall include:

- Debt per capita
- Debt as a percent of taxable value
- Debt service payments as a percent of current revenues and current expenditures
- The level of overlapping net debt of all local taxing jurisdictions.

In assessing affordability, the City shall also examine the direct costs and benefits of the proposed project. The decision on whether or not to assume new general obligation debt shall be based on these costs and benefits, current conditions of the municipal bond market, and the City's ability to "afford" new debt as determined by the aforementioned measurements. The Department of Finance shall strive to achieve and/or maintain these standards at a low to moderate classification.

For City projects that are self supporting and financed by the issuance of lease revenue bonds or certificates of participation where the General Fund becomes the legal obligor of the debt, or when the General Fund insures or guarantees the debt obligation of the project, then the target debt service coverage ratio for debt issued to finance such self supporting City projects shall be at a minimum 125%.

4.2 Coverage Targets for Revenue Bonds

When appropriate, self-supporting revenue bonds shall be issued before general obligation bonds. In determining the affordability of proposed revenue bonds, the City

will perform an analysis comparing proposed annual revenues to estimated annual debt service. For the City to issue new revenue bonds, revenues, as defined in the ordinance authorizing the revenue bonds in question, shall be a minimum of 125% of average annual debt service and 110% of debt service for the year in which the payment requirements are scheduled to be the greatest (i.e. maximum annual debt service). As a planning target, however, estimated revenues will be required to be maintained at 150% of the maximum annual debt service for financial planning purposes. The City will make annual adjustments to any rate structure relating to revenues pledged to a bond issue, if necessary to maintain a 150% coverage factor.

4.3 Coverage Targets for Tax Allocation Bonds

When issuing Tax Allocation Bonds, the Pasadena Community Development Commission shall consider a target debt service coverage ratio of 125%.

CHAPTER V

LIMITATIONS ON CITY INDEBTEDNESS

All debt incurred by the City of Pasadena will adhere to legal limits set by the State of California and legal limits set by the City Council. Currently, legal limits exist for general obligation debt (full faith and credit pledge).

5.1 City and State Legal Limits on General Obligation Bonds

City Limit - In accordance with City Charter section 910, the City is subject to a bonded debt limit, for an amount, which in the aggregate, may not exceed 15% of the assessed value of all real and personal property within the City subject to taxation for municipal purposes.

State Limit - Pursuant to Article XIII of the California Constitution, the City may issue general obligation bonds only for the acquisition and improvement of real property and after approval of two-thirds of the voters voting on the proposition.

5.2 Non-Restrictive Debt

Long-term obligations payable solely from specific pledge sources, in general, are not subject to a debt limitation. Examples of non-restrictive debt include those which achieve the financing or refinancing of projects provided by the issuance of debt instruments that are payable from restricted revenues or user fees (Enterprise Funds); revenues generated from a project; special assessment districts; and tax increment revenues collected from within a redevelopment project area. In addition, these long-term obligations do not constitute obligations with a claim against any other resources of the government if the pledged sources are insufficient. Taxes levied in regards to the formation of special assessment districts and special taxes, however, must be approved by two-thirds of the voters within the district.

CHAPTER VI

TYPES OF DEBT

There are many different types of financing instruments available to the City. The City's selection among available financing instruments depends on legal constraints, investor demand, capital market activity and the type of project being financed. The following are

brief summaries of different types of financing instruments that are permitted in the City of Pasadena.

6.1 General Obligation Bonds (GOB)

General obligation, or “Full Faith and Credit,” bonds are secured by all of the general fund revenues of the City. They carry the City’s commitment to increase taxes if necessary to repay the debt. Debt service on the bonds is provided from ad valorem taxes on real property within the City. GO bonds usually achieve lower rates of interest than other financing instruments since they are considered to be a lower risk. The bond issued to build Pasadena’s Police Station is an example of a GO Bond.

General obligation bonds are usually limited by state law as to the amount and term. The City of Pasadena is subject to a bonded debt limit, for an amount, which in the aggregate, may not exceed 15% of the assessed value of all real and personal property within the City subject to taxation for municipal purposes. To be issued, these bonds must be approved by two-thirds of the voters in the City.

6.2 Utility Revenue Bonds

Utility revenue bonds are issued by the City’s Water and Power Enterprises to finance capital projects. The utilities do not have taxing authority but may sell bonds which are repaid through restricted revenues and user fees. The revenues generated by the utilities must be sufficient to cover the debt repayment and interest. The Utility Revenue Bonds will not be secured by any pledge of ad valorem taxes or general fund revenues of the City and will be payable solely from the City’s Utility Fund. When the City finances capital projects by issuing revenue bonds, the term of the bonds will not exceed the expected life of those projects.

The issuance of revenue bonds requires City Council approval but does not require voter approval.

6.3 Certificates of Participation (COP)

The Certificate of Participation is a widely used type of debt instrument that allows the City to finance capital projects/public facilities/equipment where the COP holders are repaid principal and interest through revenues generated from the project or by the City’s agreement to lease the facilities or equipment. Debt service on a COP is subject to annual appropriation by the City. For COPs issued in connection with financing of certain equipment purchases or other assets, the interest and principal repayment is budgeted in each year’s operating budget until the obligation is repaid.

Any City-owned and operated multi-use facility improvement can be financed with a COP. Specific City assets, lease or installment agreements, as well as operating revenues, may be pledged to guarantee payment of the Certificates. Upon repayment of the COP, title to the asset is transferred to the City.

COPs do not constitute indebtedness under the state or city's constitutional debt limit and do not require voter approval. COP's are the most frequently used form of City-issued debt.

6.4 Tax Allocation Bonds (TABS)

TABS are special obligations of an Agency secured by pledged tax increment revenues within the individual project area. The bonds are not a debt of the City and are not payable out of any funds or properties other than those of the Agency. Examples are TABS issued by the Pasadena Community Development Commission (PCDC), a City of Pasadena affiliated agency. The principal and interest of the TABS are funded by property tax increments, which are additional tax earnings from appreciating properties in redevelopment areas. PCDC uses the financing to develop and/or renovate commercial and low- to moderate-income residential projects. Such projects are important in revitalizing a community and in creating jobs.

6.5 Special District Tax Bonds

Special District Tax Bonds are limited obligations payable solely from special tax revenues and funds pledged under the fiscal agent agreement. Neither the full faith and credit" of the City nor the State of California or any political subdivision is pledged to the payment of the bonds. Development-supported financings include Community Facilities Districts (CFDs) and Mello-Roos Bonds. One example of this type of a bond issuance is the Pasadena Community Facilities District I (Civic Center West Public Improvements) 1992 Special Tax Bond, issued to finance the acquisition and construction of public improvements in The Civic Center West Housing Project. The improvements are owed and operated by the developer, Pasadena Civic Center West, a California Limited Partnership.

Pursuant to law, the City Council is authorized to establish a community facilities district and act as the legislative body for the proposed district. The City may issue bonds for a community facilities district and may levy and collect a special tax within such district to repay such indebtedness, if two-thirds of the registered voters in the district approve the tax.

6.6 Joint Ventures Arrangements with Other Governmental Agencies

When a project serves the public interest beyond Pasadena's boundaries, the City seeks out joint arrangements where other governmental bodies share the debt burden. Joint Venture debt is repaid through revenues generated by the project. The City will only be liable for its share of debt service, as specified by contract. One example of a joint venture financing is the construction of a parking structure at 199 North Garfield Avenue in Pasadena under a joint power agreement with the County of Los Angeles dated November of 1966. The City became a tenant-in-common holding a 30% share of the facility. As a result, the City receives 30% of the revenue and is liable for 30% of the annual expenses.

6.7 Special Assessment Bonds

Special Assessment Districts are legally designated geographic areas located within the City, which, through the consent of the affected property owners, pay for basic infrastructure and public improvement to the area through a supplemental assessment. Bonds issued for financing projects of the district are repaid by special assessments of the property owners. This financing approach achieves the objective of tying the repayment of debt to those property owners who directly benefit from the improvements financed.

6.8 Tax Revenue Anticipation Notes (TRAN)

The City may choose to issue Tax Revenue Anticipation Notes to fund internal working capital cash flow needs, if such notes are judged by the Director of Finance to be prudent and advantageous to the City. A TRAN is a short-term note that is issued, in part, to finance the City's Operating General Fund cash flow requirements during the fiscal year. The proceeds from the sale of the TRAN allow the City to cover periods of cash shortfalls resulting from a mismatch between timing of revenues and timing of expenditures. City expenditures tend to occur in relatively level amounts throughout the year, while receipts follow an uneven pattern. As tax payments and other revenues are received they are used in part to retire the TRAN.

Before issuing such notes, cash flow projections will be prepared by the Department of Finance and reviewed by the Director of Finance. The timing of the note sale, the notes' due date, the timing, segregation, and mechanisms of funds for repayment will be components of the cash flow and cash management analysis performed by the City.

6.9 Lines and Letters of Credit

Where their use is judged by the Director of Finance to be prudent and advantageous to the City, the City has the power to enter into agreements with commercial banks or other financial entities for purposes of acquiring lines or letters of credit that shall provide the City with access to credit under terms and conditions as specified in such agreements, and/or to provide a liquidity facility or credit enhancement to the City's variable rate debt

issues. Before entering into any such agreements, takeout financing for such lines or letters of credit must be planned for and determined to be feasible by the Director of Finance. Any agreements with financial institutions for the acquisition of lines or letters of credit shall be approved by the City Council.

6.10 Bond Anticipation Notes

Where their use is judged by the Director of Finance to be prudent and advantageous to the City, the City may choose to issue Bond Anticipation Notes as a source of interim construction financing. Before issuing such notes, takeout financing for such notes must be planned for and determined to be feasible by the Director of Finance.

6.11 Tax Exempt Commercial Paper

The City may choose to issue Tax Exempt Commercial Paper as a source of interim construction financing for projects contained in the City's approved Capital Improvement Program only after the Director of Finance determines that such a financing represents the least cost interim financing option for the City. Furthermore, Tax Exempt Commercial Paper shall not be issued for City capital programs unless it is of sufficient economic size, as determined by the Director of Finance. A report recommending the issuance of Tax Exempt Commercial Paper must first be approved by the Director of Finance, before recommendations are made to City Council authorizing the establishment of such a program. The term on the Tax Exempt Commercial Paper shall not exceed 270 days. If the City chooses to implement a rolling Commercial Paper program, then the term on the rolling Commercial Paper program shall not exceed five years.

6.12 Multifamily Housing Revenue Bonds and Single Family Housing Revenue Bonds

Typically, Housing Revenue Bonds are development-supported bonds where debt service is paid out of the project's revenues and guaranteed by the developer and third-party insurance companies. The City may choose to issue these tax-exempt housing bonds to help finance housing projects and build low-income housing units (typically 20% of the total residential units) within the project. Neither the full Faith and credit of the City nor the State of California or any political subdivision is pledged to the payment of credit of the bonds. An example of this type of issuance is the Civic Center West Multifamily Housing Revenue Bonds Series A & B.

CHAPTER VII

STRUCTURE AND TERM OF CITY INDEBTEDNESS

7.1 Term of Debt

Debt will be structured for the shortest period possible, consistent with a fair allocation of costs to current and future beneficiaries or users. Generally, borrowings by the City should be of a duration that does not exceed the economic life of the improvement that it finances and where feasible should be shorter than the projected economic life.

7.2 Rapidity of Debt Repayment

Debt will be structured to achieve the lowest possible net cost to the City given market conditions, the urgency of the capital project, and the nature and type of security provided. Moreover, to the extent possible, the City should design the repayment of debt so as to recapture rapidly its credit capacity for future use and match its cash flow to the anticipated debt service payments.

7.3 Backloading

The City will seek to structure debt with aggregate level principal and interest payments over the life of the debt. "Backloading" of debt service will be considered only when natural disasters or extraordinary or unanticipated external factors make short-term payments on the debt prohibitive; when the benefits derived from the debt issuance can clearly be demonstrated to be greater in the future than in the present; when such structuring is beneficial to the City's aggregate overall amortization schedule; or when such structuring will allow debt service to more closely match project revenues during the early years of the project's operation.

7.4 Term Bonds, Serial Bonds, And Capital Appreciation Bonds (CABs)

Serial bonds are bonds maturing annually (or serially) in specified amounts. Term bonds are those where all bonds, or a portion of the issue equal to that which would mature over a period of two or more years in a serial issue, mature at a single time. Term bonds can be structured so that a portion of term maturity is mandatorily called or retired each year (called "sinking") to mirror a serial bond structure. Capital Appreciation Bonds (CABs) are deep discounted bonds that pay investors the face value of the bonds upon maturing. CABs will be utilized in certain cases to better manage a project's cash flow to the bond's debt service.

The decision to use term, serial, or CAB bonds is typically driven by bond marketing conditions. Specifically, if there is strong demand or weak demand for a particular bond maturity, the underwriter may combine two or more year's serial maturities as a term bond to take advantage of the strong demand or avoid the weak demand.

The City will structure its bond issues as serial, term, or CABs combinations in order to realize the lowest interest cost possible and to respond to market demand, or lack thereof, for specific bond maturities.

7.5 Use of Variable-Rate Securities

When appropriate, the City may choose to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities. The decision to issue such securities will be determined by the Director of Finance and approved by the Finance Committee and the City Council. In making the determination, the Director of Finance will evaluate and revise the City's debt portfolio and review the City's assets and liabilities.

7.6 Debt Service Reserve Fund

In situations where there is significant uncertainty about expected revenues, the City will issue additional funds when sizing the bond issue to provide for the funding of a debt service reserve fund. These reserve funds are available to the Trustee to make principal and interest payments to bondholders in the event that other available funds are insufficient to do so. In lieu of a cash-funded debt service reserve fund for a financing and in those cases where it is economically beneficial to do so (e.g. the cost of the insurance policy, surety bond, or letter of credit is less than the net interest cost on the bonds issued to fund such reserve), the City may purchase an insurance policy, a surety bond, or a letter of credit from a provider satisfying the applicable rating and other requirements of the related bond documents for the purposes of funding all or a portion of the debt service reserve fund requirement.

7.7 Sinking Funds

A sinking fund is commonly used to accumulate debt service funds in order to retire term bonds at or before their scheduled maturity. The funds paid into the sinking fund each year may be used at that time to retire a portion of the term bonds ahead of their scheduled redemption. The sinking fund also ensures that the payment of funds at maturity does not overtax the issuer's resources at that time.

7.8 Bidding Parameters

The notice of sale will be carefully constructed so as to ensure the best possible bid for the city, in light of existing market conditions and other prevailing factors. Parameters to be examined include:

- Limits between lowest and highest coupons
- Coupon requirements relative to the yield curve
- Method of underwriter compensation, discount or premium coupons

- Use of true interest cost (TIC) versus net interest cost (NIC)
- Use of bond insurance
- Deep discount bonds
- Variable rate bonds
- Call provisions
- Bond elections

CHAPTER VIII

METHOD OF ISSUANCE AND SALE

8.1 Authority and Responsibility

The Director of Finance coordinates the administration and issuance of debt and is responsible for selecting the financing team and for the accuracy of disclosure and other bond related documents. In addition to the Director of Finance, the City Treasurer will serve on the financing team, along with any other finance staff member appointed by the Director of Finance.

The Finance Department will coordinate the issuance of all debt, including issuance size, debt structuring, pledging of repayment sources and method of sale. **All borrowing requests or debt refunding proposals are to be communicated to and coordinated by the Director of Finance.** Each debt proposal will be evaluated by comparing it with competing proposals on the basis of the benefits derived, the prioritized needs of the Pasadena community and limits of debt that can be prudently and legally absorbed. All requests will be prioritized based upon these evaluations and submitted for City Management, City Council and where applicable, voter approval.

The Director of Finance, working with the City Attorney will manage any legal activities that may arise with respect to issuance of the bonds. In circumstances where there may be legal uncertainty about some aspect of a proposed bond transaction, the City may pursue a validation action to obtain judicial approval before the bonds are issued. If a bond transaction is controversial and gives rise to a reverse validation action, the City may find itself a party to that litigation.

Furthermore, after the bonds are issued, the City (acting through the Director of Finance) will be ultimately responsible for:

- Supervising, investing and administering the expenditure of construction bond proceeds;
- Collecting, or monitoring the collection of, revenues;
- Applying pledged revenues to pay operating expenses and debt service;
- Complying with all undertakings, covenants and agreements;
- Managing any enterprise funded by the debt;
- Filing of any reports required with various governmental regulators, a bond insurer or other credit enhancement provider, if any, and the credit rating agencies;
- Addressing any problem that may arise with respect to the bonds, such as a shortfall in revenues, a tax audit or a regulatory issue;
- Preparing, reviewing and filing Annual Reports and Listed Event Notices under SEC Rule 15c2-12.

8.2 Method of Sale

Debt issues are sold to an underwriting syndicate either through a competitive bid or a negotiated sale. The selected method of sale will be that which is the most advantageous to the City, in the judgment of the Director of Finance, in terms of lowest net interest rate, most favorable terms in the financial structure used, market conditions, and prior experience. The City Council must approve the process selected prior to the sale.

Negotiated Bonds - In general, City debt is issued through a negotiated process with the exception of the City's utility revenue bonds. The City of Pasadena has a reputable name in the municipal finance market and is a frequent and sophisticated issuer. The City has in-house staff expertise and is in continuous communication with rating agencies, trustees and the municipal investment market. The negotiated sale process provides the City control over the financing structure, the issuance timing, and provides flexibility of distribution.

Competitive Bonds - All Revenue Bonds issued by the City for its water and power utilities will be sold on a competitive basis in accordance with the City Charter requirements. In a competitive sale, bids will be awarded on a true interest cost basis (TIC), providing other bidding requirements are satisfied. In such instances where the City deems the bids received unsatisfactory, it may, at the election of the City Council, enter into negotiation for sale of the securities or reject all bids.

Private Placement - When determined appropriate by the Director of Finance, the City Treasurer will negotiate financing terms with banks and financial institutions for specific borrowings. Typically, bank financings are carried out by the City to avoid the costs of public offering and therefore reduce the cost of borrowing funds for issues typically less than \$10,000,000.

8.3 Debt Instrument Rating

As indicated above, the City's credit objective is to maintain Pasadena's high credit rating. The Finance Director, with the financial advisor, if appropriate, will assess the probable rating of the proposed debt before its issuance and take the necessary steps to ensure that a high rating will result. There are various considerations in obtaining a high rating. These include economic conditions related to the stability and reliability of sources for debt repayment; the City's reserve levels; the City's debt history and current debt structure; the City's fiscal responsibility; and the City's general management capabilities.

The Department of Finance will consider the use of credit enhancement if it reduces the overall cost of the proposed financing. A Letter of Credit may be secured from a major bank to enhance the credit rating. This letter is an unconditional pledge of the bank's credit to make principal and interest payments of a specified amount on the City's debt for a specified time in the event of short term lack of funds. Bond insurance is also a potential means of increasing the debt's rating. However, both of these rating

enhancement methods represent an added cost in terms of the bank's fee or the insurer's premium. Also, the need to use these enhancements may indicate an inherent risk associated with the project.

8.4 Disclosure Requirements

The Finance Department with the assistance of professional support will produce all the necessary documents for disclosure. All debt issues will meet the disclosure requirements of the SEC and other government agencies before and after the bond sales take place. The purpose of the SEC requirements is to deter fraud and manipulation in the municipal securities market. The disclosure documents, particularly the Official Statement, will provide the potential investor with full and accurate information necessary to make prudent investment decisions. Information generally includes the City government description, comprehensive annual financial data, its tax base, current debt burden, history of tax collection and bond repayment, future borrowing plans, and the source of funds for the proposed debt repayment, as well as specific bond data.

The City will also provide ongoing disclosure on the status of the following material events, as obligated:

- Principal and interest payment delinquencies
- Nonpayment-related defaults
- Unscheduled draws on reserves
- Unscheduled draws on credit enhancements
- Substitution of credit or liquidity providers, or the failure to perform
- Adverse tax opinions or events affecting the tax-exempt status of the security
- Modifications to rights of security holders
- Bond calls
- Defeasances
- Matters affecting collateral
- Rating changes

8.5 Inter-government Coordination

All capital requests will explore the interaction and funding potential with other government agencies. Where appropriate, communications and coordination will be made with other local, state, and federal governments regarding potential jurisdictional overlap, joint projects, tax issues, and other issues that may arise. If potential does exist, then the possibility for grants or cost sharing will be explored, quantified and specific financial arrangements and liabilities negotiated.

CHAPTER IX
SELECTION OF FINANCE CONSULTANTS AND
SERVICE PROVIDERS

9.1 Authority and Responsibility

The Director of Finance shall be responsible for establishing a solicitation and selection process for securing professional services that are required to develop and implement the City's debt program. Goals of the solicitation and selection process shall include encouraging participation from qualified service providers, both local and national, and securing services at competitive prices. The identification of team members is accomplished through an interview process conducted by the Finance Department, and may also be based upon recommendations from advisors that are specifically skilled in the type of bond issue being proposed. It has been the City's policy to have the financing team for debt issuance approved by the City Council through the Finance Committee.

9.2 Professional Services Support

One of the first decisions to be made by the City is the selection of the initial members of its debt financing team, including bond counsel and either a financial advisor or underwriter or both. The nature of the team members may depend upon several factors, including the type of debt being issued, procedural requirements for that type of debt and the level of in-house sophistication of the issuer.

The City will maintain professional service agreements with qualified professionals related to the issuance and management of debt, including but not limited to:

Bond Counsel – The City will retain external bond counsel for all debt issues. As part of its responsibility to oversee and coordinate the marketing of all City indebtedness, the Director of Finance shall make recommendations to the City Council regarding the selection of Bond Counsel to be employed and the duration of the employment for individual or a series of financings. The solicitation and selection process for such services will comply with City Code requirements. The Council shall make such selection, taking into consideration these recommendations. Bond counsel will prepare the necessary authorizing resolutions, agreements and other documents necessary to execute the financing. All debt issued by the City will include a written opinion by bond counsel affirming that the City is authorized to issue the debt, stating that the City has met all state constitutional and statutory requirements necessary for issuance, and determining the debt's federal income tax status.

Underwriters' Counsel – If the financing is to be sold on a negotiated basis, the City will select an underwriter's counsel. Underwriters' counsel's primary responsibility is to provide legal advice to the Underwriter, prepare the purchase contract and the disclosure documents (OS). Generally, the Underwriter's Counsel will also serve as the Disclosure Counsel.

Payments for underwriter's counsel will be authorized by the Director 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 – A financial advisor shall be selected for all transactions to be sold on a competitive basis. At the direction of the Director of Finance, a financial advisor maybe selected for bonds sold on a negotiated basis. The primary responsibilities of the financial advisor are to advise and assist on the structuring, call provision options, rating and issuance of debt, timing of issuance, and generally act as an independent financial consultant and economic market expert.

Trustee and Paying Agent - The City Treasurer, in consultation with the Director of Finance, shall periodically solicit for trustees and paying agent services from qualified commercial and trustee banks. Based on the cost of providing such services, along with other qualitative measurements, the Director of Finance shall recommend the paying agent and the term of such agreement to City Council.

Other Service Providers - Other professionals may be selected, at the direction of the Director of Finance, on an as-needed basis. These include the services of managing underwriters, credit agencies, escrow agent, and the printer.

9.3 Underwriters

The Director of Finance shall solicit proposals for underwriting services for all debt issued in a negotiated or private placement sale mode.

The underwriting syndicate is a firm or a group of firms that will purchase all of the bonds and then resell them to investors. The criteria used to select an underwriter in a competitive sale shall be the true interest cost. For all negotiated sales, underwriters will be required to demonstrate sufficient capitalization and experience related to the debt issuance being proposed. In a negotiated sale, the Director of Finance will recommend to the City Council the selected underwriter. The Director of Finance will consider the following criteria in selecting an underwriter:

- Overall experience
- Marketing philosophy and distribution
- Capability
- Previous experience as managing or co-managing underwriter
- Financial strength, as evidenced by the firm's current financial statement
- Experience of the public finance team assigned to the financing
- Resources to complete the financing
- Total overall, and breakdown of underwriter's discount

The selection of underwriters may be for an individual or series of financings or a specified time period. The Council shall make such selections taking into consideration the recommendations of the Director of Finance.

9.4 Compensation for Services

Compensation for bond counsel, underwriter's counsel, financial advisors, and other financial services will be as low as possible, given desired qualification levels, and consistent with industry standards. All costs and fees related to issuance of bonds will be paid out of bond proceeds.

CHAPTER X

REFUNDING OF CITY INDEBTEDNESS

10.1 Call Options

The Director of Finance will determine the call option, if any, the call protection period and the call premium for each bond sale. A call option, or optional redemption provision, gives the City the right to prepay or retire debt prior to its stated maturity. This option may permit the City to achieve interest savings in the future through refunding of the bonds. Often the City must pay a higher interest rate as compensation to the buyer for the risk of having the bond called in the future. In addition, if a bond or debt is called, the holder may be entitled to a premium payment ("call premium"). Because the cost of call options can vary widely, depending largely on market conditions, an evaluation of factors such as the following will be conducted in connection with each issue:

- The call premium
- Level of rates relative to historical standards
- The time until the bonds may be called at a premium or at par
- The need for original issue discounts.

10.2 Advance Refunding

Periodic reviews of all outstanding debt will be undertaken to determine refunding opportunities. Within federal tax law constraints, a refunding will be considered if and when there is a net economic benefit or if it is essential in order to modernize covenants essential to operations and management.

Advance refundings are used to refinance outstanding debt before the date the outstanding debt becomes due or callable. New bonds that are issued to refinance an outstanding bond issue 90 days or more before the call date are known as advance refunding bonds. Proceeds of the advance refunding bonds are placed into an escrow account with a fiduciary and used to pay interest and principal on the refunded bonds and then redeem them at their maturity or call date.

As defined for federal tax law purposes, the City may issue advance refunding bonds when advantageous, legally permissible, prudent, and when aggregate net present value savings, expressed as a percentage of the par amount of the refunding bonds, equal or exceed 3%. Exceptions to this requirement shall be made only upon the approval of the Director of Finance. Refundings with negative savings will not be considered unless there is a compelling public policy objective.

10.3 Current Refunding

Current refundings are used to refinance outstanding debt on or after the date the outstanding debt becomes due or callable and within 90 days of the date of issuing the refunding bonds. New bonds that are issued to refinance an outstanding bond issue on or after the call date are known as current refunding bonds. Managers of existing projects may request refundings, for the purpose of taking advantage of more favorable economic conditions and lower market interest rates, restructuring the principal and debt service payments or eliminating burdensome covenants with bondholders.

As defined for federal tax law purposes, the City may issue current refunding bonds when advantageous, legally permissible, prudent, and aggregate net present value savings equal or exceed 3%.

The financial advantages of a current refunding must outweigh the cost of reissuing bonds. The request for refunding will be assessed with competing new capital projects requiring financing. The benefits of the refunding will be assessed against its costs and risks and compared to other funding requests.

10.4 Restructuring of Debt

The City may choose to refund outstanding indebtedness when existing bond covenants or other financial structures impinge on prudent and sound financial management. Savings requirements for current or advance refunding undertaken to restructure debt may be waived by the Director of Finance upon a finding that such a restructuring is in the City's overall best financial interest.

10.5 Refunding Escrows

The City will seek to purchase State and Local Government Securities (SLGS) to fund its refunding escrows. At the direction of the Director of Finance, the City may choose to fund an escrow through purchase of treasury securities on the open market when market conditions make such an option financially preferred. The City Treasurer and the Director of Finance shall be responsible for developing procedures for executing open market purchases and the savings objectives to be achieved by undertaking such actions.

CHAPTER XI

CREDIT ENHANCEMENT, **DERIVATIVES & CONDUIT FINANCINGS**

11.1 Credit Enhancement

The City shall seek to use credit enhancement (letters of credit, bond insurance, surety bonds, etc.) when such credit enhancement proves cost-effective. Credit enhancement may be used to improve or establish a credit rating on a City debt obligation even if such credit enhancement is not cost effective if, in the opinion of the Director of Finance, the use of such credit enhancement meets the City's debt financing goals and objectives.

11.2 Derivative Products

The City may in the future choose to enter into contracts and financing agreements involving interest rate swaps, floating/fixed rate auction or reset securities, or other forms of debt bearing synthetically determined interest rates as authorized under the applicable statutes. The City will consider the use of derivative products on a case-by-case basis and consistent with state statute and financial prudence.

Before entering into such contracts or agreements, the Director of Finance and the City Treasurer will review the risks and benefits of such financing techniques and expected impacts on the City's long-term financial operations and credit ratings. The report, when completed, shall be presented to the Finance Committee for approval before any recommendations are submitted to the City Council for authorization and implementation.

11.3 Conduit Financings

The City may sponsor conduit financings 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.

All conduit financings must insulate the City completely from any credit risk or exposure and must first be approved by the Director of Finance before being submitted to City Council for authorization and implementation.

CHAPTER XII

REVIEW OF FINANCING PROPOSALS

12.1 Authority and Responsibility

Any capital financing proposal or refunding proposal made to the City involving a pledge or other extension of the City's credit through the sale of securities, execution of loans or leases, or making of guarantees or otherwise involving directly or indirectly the lending or pledging of the City's credit shall be referred to the Director of Finance.

The Director of Finance shall be responsible for analyzing the proposal, responding to the proposal, and recommending to the Finance Committee and the City Council if in the opinion and judgment of the Director of Finance the proposed financing request is beneficial to the City of Pasadena and complies with the City's long-term financial planning.

CHAPTER XIII

REPORTING REQUIREMENTS

13.1 Annual Audit of the City

The annual audit of the City shall describe in detail all funds and fund balances established as part of any direct debt financing of the City. The audit may also contain a report detailing any material or rate covenants contained in any direct offering of the City and whether or not such covenants have been satisfied.

13.2 Arbitrage Compliance

The Director of Finance shall establish and maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of federal tax code. This effort shall include tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the City's outstanding debt issues. Additionally, general financial reporting and certification requirements embodied in bond covenants shall be monitored to ensure that all covenants are complied with.

APPENDIX A

DERIVATIVES POLICY

14.1 Overview

The City may, from time to time, choose to enter into contracts and financing agreements involving derivatives as authorized under the City Charter and state law. The City will consider the use of derivative products on a case-by-case basis. Properly used, derivative products can be beneficial financial management tools that can assist the City as part of its overall debt and investment management program.

14.2 Acceptable Derivative Objectives

Derivative products are appropriate for use when they are designed to achieve specific financial objective(s) consistent with the City's overall financial policy and strategy. The City will execute a derivative product if it achieves one or more of the following objectives:

- To achieve a lower net cost of borrowing
- To prudently hedge risk in the context of a particular financing, such as capping or hedging variable interest rate risk
- To provide a better match between the interest rates on the City's debt and its investments (asset/liability management), resulting in an increased net investment return
- To achieve more flexibility in meeting overall financing objectives, such as altering the pattern of debt service payments or locking in savings on a refunding
- To manage exposure to changing markets in advance of anticipating bond issuances (through the use of anticipatory hedging instruments)

14.3 Prohibited Agreements

The City will not enter into any derivative transactions if the following conditions are present:

- The derivative is intended for speculative purposes
- The derivative will create extraordinary leverage or other financial risk
- The derivative exposes the City or the swap provider to a situation in which either would have insufficient liquidity to terminate at current market rate
- The City's finance team is unable to reasonably value the instrument

14.4 Permitted Investments

The City will consider the following derivative instruments as acceptable:

- Interest rate swaps including synthetic fixed rate, synthetic variable rate, basis swaps, current swaps, and forward starting swaps
- Reverse swaps
- Options including swaptions, caps, floors, collars and/or cancellation or index-based features
- Interest rate caps/floors/collars

14.5 Derivative Approval Procedures

Before entering into derivative contracts or agreements, the Director of Finance and the City Treasurer will review the risks and benefits of such financing techniques and expected impacts on the City's long-term financial operations and credit ratings. The proposed derivative product will only be considered if it meets the objectives of the City as described herein. A Risk/Benefit Analysis Report will be prepared, under the supervision of the Director of Finance, which evaluates the derivative. The Director of Finance may, at his/her discretion, employ the services of an advisor in preparing the Report. The Report, when completed, shall be presented to the Finance Committee for approval before any recommendations are submitted to the City Council for authorization and implementation. All derivative transactions shall be authorized by the City Council.

14.6 Risk/Benefit Analysis Report

In the Risk/Benefit Analysis Report, the City will identify and evaluate the proposed benefit of the product.

Savings Analysis - The City will obtain an analysis of potential savings from proposed transaction using a consultant or financial advisory firm experienced in the pricing of swaps. The City will enter into derivative products only if such products are expected to generate savings, including all ongoing costs and fees, as

compared to a transaction without the derivative product. However, if in the opinion of the Director of Finance, the derivative achieves a different public purpose other than savings, the savings threshold may not apply. The Director's justification for waiver of this threshold will be provided in the Report.

The Report will also detail the potential risks of the derivative product and shall discuss the means employed to mitigate the risks.

Risk Analysis - The City will also address any methods to mitigate the identified risks. The following risks will be considered, and the related mitigating factors explained:

- A. Market/Interest Rate Risk: Risk of exposure to fluctuations in interest rates.
- B. Amortization Risk: Risk of a mismatch of the expiration of the underlying obligation and its hedge (the swap agreement). Amortization risk includes the possibility that, as the result of early redemption of the underlying variable rate bonds, the repayment schedule of the bonds differs from the underlying notional amount of the swap agreements. The risk only arises if the City elects to redeem bonds ahead of schedule. At the discretion of the Director of Finance, the City shall attempt to mitigate this risk by setting the term of the swap to meet its more conservative expectations regarding final repayment of the underlying obligation.
- C. Tax Law Risk: Risk of rate adjustments, extraordinary payments, termination or other adverse consequences in the event of a future change in Federal income tax policy.
- D. Termination Risk: Termination risk refers to the possibility that the City may be required to make a large payment to the counterparty if a swap agreement is terminated prior to its scheduled maturity pursuant to its terms (i.e. other than at the option of the City). Termination exposure will be evaluated on a per-project and per-counterparty basis for all existing and proposed transactions. The City will attempt to mitigate this risk by maintaining sufficient liquidity to cover this exposure and limiting the events that trigger an early termination, including the selection of counterparties with strong creditworthiness.
- E. "Performance" Risk: Risk of a future financing(s) that is dependent upon third party participation, such as a forward starting swap. The City will attempt to mitigate this risk by obtaining commitments that can be or have been secured for such participation.
- F. Legal Authority Risk: Risk of any party's legal authority to participate in the transaction.

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- G. Counterparty Risk: Risk that the counterparty fails to make its required payments. The City will attempt to minimize counterparty risk by establishing minimum counterparty credit standards and by diversifying the City's exposure to individual counterparties. The exposure shall be measured both in terms of amount as well as how changes in interest rates would affect the City's exposure.
- H. Rollover Risk: Risk that the City may need to find a replacement counterparty as part of an overall plan of finance if an interest rate swap does not extend to the final maturity of the underlying variable rate bonds. Rollover risk can be minimized in the initial plan of finance by not relying on the execution of future swap agreements to achieve the City's financing objectives.
- I. Credit Risk: Risk of changes in the credit-worthiness of the counterparty. The City will attempt to mitigate this risk by setting minimum counterparty credit standards and by including provisions in the documents to limit exposure to adverse changes in the counterparty's credit standing.
- J. Liquidity/Remarketing Risk: Risk that the City cannot secure a cost effective renewal of a Letter or Line of Credit, or suffers a failed auction or remarketing with respect to the underlying variable rate bonds.
- K. Ratings Risk: Risk that the transaction could impact the City's current credit ratings, or its desired future ratings, and with related rating agency policies.
- L. Basis Risk: Risk that the basis for the anticipated payments that the City would make or receive would not match the payments that it seeks to hedge. The City will evaluate different swap indices as part of its analysis and identify the amount of basis risk that may result from each.
- M. Tax Exemption of City Debt Risk: Risk that the transaction is not in compliance with all Federal tax law requirements with respect to the City's outstanding tax-exempt bonds.
- N. Accounting Risk: Risk that the transaction is not compliant with accounting procedures and consistent with the City's financial statements. Additional risk of impact on the City's rate covenant calculation or compliance, where applicable.
- O. Administrative Risk: Risk of the ability of the City to administer and monitor the transaction consistent with the policies outlined in the Debt Policy.

- P. Subsequent Business Conditions: Risk of dependence on the continuation or realization of specific industry or business conditions.

14.7 Methods of Soliciting and Procuring Derivatives

The City may procure a derivative on either a competitive or negotiated basis, at the discretion of the Director of Finance. Regardless of the method of procurement, the City shall obtain an independent finding from a qualified source that the terms and conditions of any derivative entered into reflect a fair market value as of the date of its execution.

- A. Competitive: If a competitive basis of procurement is selected, the City may undertake a limited competitive process from pre-qualified bidders. The City may select one or more winning bidders for the transaction in addition to the best bidder, if deemed in City's best interest.
- B. Negotiated: The Director of Finance may determine that due to size or complexity of the transaction, a negotiated process would result in the most favorable pricing. In such case, an independent financial advisor may be retained to assist in the process. The Director of Finance might also determine that a negotiated process is appropriate to encourage innovation or the substantial commitment of time and resources by a counterparty.

14.8 Form of Swap Agreements

To the greatest extent possible, any interest rate swap agreements entered into by the City will contain the terms and conditions set forth in the International Swap and Derivatives Association, Inc. ("ISDA") Master Agreement, including any schedules and confirmations. However, the City will seek to amend the standard terms and conditions as is appropriate for the City's benefit. The City may use additional documentation if the product is proprietary, or if the City deems that such documentation is in the City's best interest.

14.9 Minimum Counterparty Requirements

The City will enter into derivative transactions only with qualified counterparties. The City will employ the following minimum counterparty requirements:

A. Minimum Rating:

1. Rated at least A3 or A- or equivalent by any two of the three nationally recognized rating agencies (Moody's, Standard and Poor's, and Fitch), or
2. Be an institution utilizing non-terminating AAA subsidiary, as rated by at least one nationally recognized rating agency.

B. Minimum Capitalization:

1. \$50 million minimum

C. Demonstrated Record:

1. Successfully executing and performing in swap transactions.
2. Creating and implementing innovative ideas in the swap market.

In addition to the rating criteria, capitalization, and experience requirements outlined in this section, the City may seek credit enhancement and/or other safeguards:

- Contingent credit support or enhancement
- Collateral held by 3rd party trustee and marked-to-market on a monthly basis
- Ratings downgrade triggers
- Guaranty of parent, if any

The City shall limit exposure to individual counterparties, based on the credit rating of the counterparty as well as on the relative risk associated with each derivative transaction. (Refer to page 42 for counterparty limits.)

14.10 Standard Terms for Derivatives

The City will seek to attain the following standard terms in the derivative agreement:

- A. Term: The City shall determine the appropriate term for an agreement on a case-by-case basis. The term will be consistent with the purpose for which swap it is utilized, while taking into account the call dates for the related debt. In no event shall the term extend beyond the existing debt (or other obligation being hedged).
- B. Events of Default: An event of default by the counterparty shall lead to termination of the agreement, with the termination payment being calculated on the side of the bid-offered spread most beneficial to the City. Events of default of a counterparty shall include the following:
1. Failure to make payments when due;
 2. Material breach of representations and warranties;

3. Failure to comply with downgrade provisions; or
 4. Failure to comply with any other provision of the agreement after a specified notice period.
- C. Specified Indebtedness Related to Credit Events: The specified indebtedness related to credit events in any agreement shall be narrowly defined and shall refer only to the indebtedness of the City that could have a materially adverse effect on the City's ability to perform its obligations under the agreement. Debt shall include only those obligations within the same lien as the agreement.
- D. Downgrade Provisions: Downgrade provisions triggering terminations shall in no event be worse for the City than those affecting the counterparty.
- E. Termination Provisions:
1. Termination Value: Termination value shall be set by utilizing a Market Quotation Methodology, Second Method unless the City deems an alternate method as appropriate. As defined in the ISDA Master Agreement, under the Second Method,, the termination amount payable is equal to (i) the sum of the settlement amount as determined by the non-defaulting party plus the unpaid amounts owing to the non-defaulting party, less (ii) any unpaid amounts owing to the defaulting party.
 2. Optional: All interest rate swap transactions shall contain provisions granting the City the right to optionally terminate a swap agreement at anytime over the term of the agreement. The Director of Finance, in consultation with the City's financial advisor, shall determine if it is financially advantageous for the City to terminate a swap agreement.
 3. Mandatory: A termination payment to or from the City may be required in the event of termination of a swap agreement ONLY in the case of credit-related and non-payment events. It is the intent of the City not to make a termination payment to a counterparty that does not meet its contractual obligations. Prior to entering into the swap agreement, or making any such termination payment, as appropriate, the Director of Finance shall evaluate whether it would be financially advantageous for the City to enter into a replacement swap as a means of offsetting any such termination payment or obtaining insurance to guarantee performance of the counterparty. Any swap termination payment due from the City shall be made from available City monies and the agreement shall allow for appropriate legislative action.

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4. Available Liquidity: The Director of Finance shall consider the extent of the City's exposure to termination payment liability in connection with each swap transaction, and the availability of sufficient liquidity to make any such payments that may become due.
- F. Cure Provisions: Timelines on City's obligations to cure must provide for appropriate legislative action.
 - G. Payment: Payments may be structured on a monthly, semi-annual, or annual basis. Swap payments shall have a lien level that is no greater than parity. Whenever possible, termination payments shall have a lien level that is subordinate to related debt payments.
 - H. Security: The agreement shall identify the security attributable to the derivative.
 - I. Collateral: Collateral thresholds shall be set on a sliding scale reflective of credit ratings, size, and directional market risk of the transaction.
 1. Required: The City shall require collateral or other credit enhancement to be posted by each swap counterparty if the credit rating of the counterparty or its guarantor falls below the "A" category from any two out of the three nationally recognized rating agencies previously identified. The level of collateral will be determined on a deal by deal basis, taking into account such factors as the counterparty ratings. Additional collateral for further decreases in credit ratings of each counterparty shall be posted by such counterparty in accordance with the provisions contained in the collateral support agreement to each swap agreement.
 2. Safekeeping Requirements: Collateral will be deposited with a custodian, acting as agent for the City, or as mutually agreed upon between the City and each counterparty.
 3. Collateral Value: The market value of the collateral shall be determined on at least a monthly basis. The amount of collateral posted shall be equal to the positive termination value of the swap agreement to the City. The City will determine reasonable threshold limits for the initial deposit and for increments of collateral posted thereafter.
 4. Features of Collateral: Acceptable collateral shall include cash, U.S. Treasury securities, and U.S. Agency securities. The City shall determine on a case-by-case basis whether other forms of credit enhancement are more beneficial to the City.

14.11 Monitoring and Reporting

The City will actively manage and routinely monitor any derivative product entered into by the City. This will include frequent monitoring of market conditions to identify opportunities and risks. A written report providing the status of all derivative products entered into by the City may be prepared from time to time, as needed or requested.

Monitoring and/or reporting shall consider the following areas:

A. Agreements:

1. A summary of each swap agreement including but not limited to:
 - a. the type of swap
 - b. the rates and dollar amounts paid by the City and received by the City
 - c. the rate and amounts that were required to be paid and received, and
 - d. the current market value
2. Highlights of all material changes to swap agreements or new swap agreements since the last report.
3. Sensitivity analysis with net impact to the City of a 25 basis point movement (up or down) in the appropriate swap index or curve.
4. Actual collateral posting by each swap counterparty, if any, under each swap agreement and in total by that swap counterparty.
5. Information concerning any default by a swap counterparty under a swap agreement with the City, and the results of the default, including but not limited to the financial impact to the City, if any.
6. A summary of any swap agreements that were terminated or that have expired. Summary of key terms of agreements including notional amounts, interest rates, maturity, and method of procurement.
7. Values of early termination, shortening or lengthening the term to certain benchmarks, sale or purchase of options, and application of basis swaps.
8. Discussion of other risks associated with each transaction.
9. A summary of any planned swap transactions and the projected impact of such swap transactions to the City.

B. Counterparties:

1. Full name, description, and credit ratings of each counterparty and credit enhancer insuring swap payments, if any.
2. For each counterparty, the City 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.

3. Listing of any credit enhancement, liquidity facility or reserves, and accounting of all costs and expenses associated with the credit enhancement, liquidity facility, or reserves.
4. Current credit rating of each counterparty and credit enhancer insuring swap payments, if any.
5. Aggregate marked-to-market value for each counterparty and relative exposure compared to other counterparties.
6. Calculation of City's net termination exposure for each counterparty.

C. Benefit:

1. Comparison of the actual debt service requirements of the transaction and the projected debt service on the transaction at the time of original execution. This shall be shown on an annual basis. Such calculation shall include a determination of the cumulative actual savings versus the projected savings at the time the transaction was executed.

14.12 Swap Counterparty Termination Exposure Limits

In order to diversify the City's counterparty risk and to limit the City's exposure to any one counterparty, limits are 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 marked-to-market sensitivity of each transaction to an assumed shift in interest rates. Maximum net exposure per counterparty shall not exceed standards set by the City. Maximum net termination exposure is the amount equal to the aggregate maximum reasonably anticipated net termination payment exposure for all of the City's existing and proposed swap agreements with such counterparty. The limits vary based on the credit rating of the counterparty. If the counterparty has more than one rating, the lowest rating will govern for purposes of calculating the permissible levels of exposure.

Counterparty Credit Rating	Maximum Collateralized Net Termination Exposure	Maximum Uncollateralized Net Termination Exposure	Maximum Total Net Termination Exposure
AAA Category	\$40 million	\$40 million	\$40 million
AA Category	\$40 million	\$10 million	\$40 million
Below AA	\$30 million	None	\$30 million

14.13 Disclosure

The City shall comply with any applicable accounting standards for the treatment of derivatives. Derivatives will be disclosed in the related Official Statement, if relevant, and in the City's Annual Report. Derivatives may also be footnoted in the City's CAFR, as appropriate.

14.14 Dodd-Frank Compliance

A. Definitions

- For purposes of this Policy, the following terms shall have the following meanings:

"Authorized Persons" means the Director of Finance, The Treasurer of Pasadena Public Financing Authority, the City Manager and the Executive Director of the Pasadena Public Financing Authority;

"CFTC" means the U.S. Commodity Futures Trading Commission;

"Dodd-Frank" means the Wall Street Transparency and Accountability Act, including any regulations promulgated thereunder or in connection therewith;

"swap" and **"swap recommendation"** have the meanings set forth in Dodd-Frank;

"Swap Agreement" means an agreement governing swaps in the form of an International Swaps and Derivatives Association, Inc. master agreement, including any schedules thereto and confirmations thereunder, or other agreement, as approved by one of the Authorized Persons; and

"Swap Counterparty" means a major financial institution having its head office in the United States, Canada, or Europe which, at the time of execution of a swap, is registered with the CFTC as a "swap dealer" and will, among other things, be responsible for all reporting requirements under the Commodity Exchange Act, as amended.

B. Authority

As provided above, the City may enter into derivative product transactions such as interest rate swaps, caps, floors and collars which constitute "swaps" under Dodd-Frank, with a Swap Counterparty in connection with hedging or mitigating commercial risk relating to an asset or liability. Each Authorized Person is authorized to execute and deliver all agreements and documents related to entering into, amending, novating or terminating a swap, including but not limited to a Swap Agreement.

C. Swap Agreements

Each swap executed by the City with a Swap Counterparty shall contain terms and conditions as set forth in an International Swap and Derivatives Association, Inc. master agreement, including the Schedule and any annexes thereto and confirmations thereunder, or other agreement, as approved by one of the Authorized Persons. Any swap agreement between the City and a Swap Counterparty shall include payment, term, security, collateral, default, remedy, termination, and other terms, conditions and provisions as an Authorized Person deems necessary or desirable.

D. Conformance to Dodd-Frank

It is the intent of the City to conform this Policy to the requirements of Dodd-Frank. Pursuant to such intent, it is the policy of the City that, with respect to each swap entered into, amended, novated or terminated by the City: (i) each swap advisor engaged or to be engaged by the City will function as the designated qualified independent representative of the City, sometimes referred to as the “Designated QIR”; (ii) each swap advisor agree to meet and meets the requirements specified in Commodity Futures Trading Commission (“CFTC”) Regulation 23.450(b)(1) or any successor regulation thereto (herein referred to as the “Representative Regulation”); (iii) each swap advisor provide a written certification to the City to the effect that such swap advisor agrees to meet and meets the requirements specified in the Representative Regulation; (iv) the City monitor the performance of each swap advisor consistent with the requirements specified in the Representative Regulation; (v) the City exercise independent judgment in consultation with its swap advisor in evaluating all recommendations, if any, presented by any swap dealer with respect to swaps authorized pursuant to this Policy; and (vi) the City rely on the advice of its swap advisor with respect to swaps authorized pursuant to this Policy and not rely on recommendations, if any, presented by any swap dealer with respect to swaps authorized pursuant to this Policy.

E. Legal Entity Identifier

The City shall obtain and maintain current at all times a “legal entity identifier” from a firm designated by the CFTC to provide such numbers.

F. Clearing

In connection with the execution of swaps which are subject to a mandatory clearing determination by the CFTC, the City shall either (i) cause the swap dealer (as the “reporting party” for Dodd-Frank purposes) to report, as required by the CFTC, swap information on a swap-by-swap basis or (ii) complete and maintain, as required by the CFTC, an annual filing regarding how it generally meets its financial obligations associated with entering into uncleared swaps.

G. Recordkeeping

Comprehensive records shall be maintained, either in paper or electronic form, of any swap (including the related Swap Agreement) entered into by the City for at least five (5) years following the termination of such swap. Such records shall be retrievable within five (5) business days and shall be open to inspection by the CFTC.

APPENDIX B

BASIC LEGAL DOCUMENTS

The following basic legal documents are found in most public finance transactions.

15.1 Indenture

Purpose: The indenture is the basic security document of a bond transaction. It provides the terms of the bonds, including payment dates, maturities, redemption provisions, registration, transfer and exchange, etc. The indenture creates the legal structure for the security for the bonds, including:

- Creation and granting of the Trust Estate
- Pledge of revenues and other collateral
- Affirmative negative covenants
- Negative covenants
- Default and remedy provisions
- Flow of funds
- Parity debt provisions for issuance of additional bonds in the future
- Defeasance provisions to allow for refunding of the bonds
- Trustee-related provisions

Substitutes: Trust Agreement; Fiscal Agent Agreement; Bond Resolution or Bond Ordinance.

Principal Drafter: Bond Counsel.

Parties: Issuer, Trustee.

Critical Provisions for Issuer Review: Definitions of permitted investments and revenues; scope of trust estate and pledged collateral; payment and redemption terms of bonds; additional bonds test; flow of funds with special consideration to retaining the flexibility needed to use funds not otherwise needed for debt

service; reserve fund provisions; covenants; default and remedy provisions; defeasance provisions.

15.2 Loan Agreement

Purpose: The loan agreement is the document under which the bond proceeds are lent or otherwise provided for the project being financed and the user of the proceeds agrees to repay the amount of the bonds, plus interest. It provides for payment of loan, installment sale or lease payments sufficient in time and amount to pay debt service on the bonds.

Substitutes: Installment Sale Agreement; Facilities or Project Lease.

Principal Drafter: Bond Counsel.

Parties: Conduit Borrower/Obligator, Issuer.

Critical Provisions for Issuer Review: Representations and warranties; covenants; prepayment provisions; pledge provisions; title provisions; abatement provisions.

15.3 Authorizing Resolution(s)

Purpose: The resolution authorizes issuance and sale of bonds, authorizes execution and delivery of documents, and directs staff to take other actions necessary to complete financing.

Substitutes: Authorizing Ordinance.

Principal Drafter: Bond Counsel or Issuer's Counsel.

Parties: Issuer.

Critical Provisions for Issuer Review: Parameters for delegation of authority to sell bonds; maximum par amount and term of bonds; conformance to issuer's standard form of resolution.

15.4 Bond Purchase Agreement

Purpose: Provides for the sale of the bonds to the underwriter; specifies discount, interest rates and terms for payment of purchase price; contains representations and warranties of the issuer; contains conditions precedent to underwriter's obligation to purchase the bonds at closing; specifies documents to be delivered at closing; specifies who will pay expenses.

Substitutes: Official Notice of Sale and Bid Form (competitive sales); Placement Agreement (private placements).

Principal Drafter: Underwriter's Counsel or Disclosure Counsel.

Parties: Underwriter, Issuer, and Conduit Borrower.

Critical Provisions for Issuer Review: All points listed under "Purpose" section.

15.5 Official Statement

Purpose: The Official Statement is the document, which provides disclosures to investors and potential investors. Most financings are required to have Official Statements under SEC Rule 15c2-12. Provides disclosure to prospective investors regarding term of bonds, security, risk factors, and financial and operating information concerning issuer and background information.

Substitutes: Offering Memorandum; Limited Offering Memorandum.

Principal Drafter: Underwriter's Counsel or Disclosure Counsel.

Parties: Issuer.

Critical Provisions for Issuer Review: Security and sources of payment for the bonds; risk factors; financial and operating data regarding the entity responsible for payment; litigation; and general information about the issuer.

15.6 Continuing Disclosure Agreement

Purpose: The Continuing Disclosure Agreement contains the undertakings of the issuer to provide ongoing disclosure in the form of annual reports and event notices pursuant to SEC Rule 15c2-12. The undertakings must remain in place for the life of the issue, with certain exceptions for pool bonds.

Substitutes: Continuing Disclosure Certificate.

Principal Drafter: Underwriter's Counsel, Disclosure Counsel, or Bond Counsel.

Parties: Issuer; Obligated Persons; Trustee.

Critical Provisions for Issuer Review: Contents of annual reports; deadline for filing annual reports; listed event notices; amendment provisions.

15.7 Reimbursement Agreement

Purpose: The Reimbursement Agreement appears in transactions involving a letter of credit or surety policy guaranteeing payment on the bonds or draws against the reserve fund, respectively. It contains the obligation to repay the letter of credit bank amounts drawn on the credit facility. Term and conditions vary depending upon the type of transaction involved.

Substitutes: Financial Guarantee Agreement.

Principal Drafter: Bank Counsel, Surety Provider Counsel.

Parties: Issuer; Bank, and Trustee (in some cases).

Critical Provisions for Issuer Review: Representations and warranties; fees payable to bank; ability of bank to "participate" the credit facility to other banks; renewals and extensions of the credit facility; default and remedy provisions; collateral provisions; choice of law provisions.

15.8 Tax Certificate

Purpose: The Tax Certificate contains certifications required to be made by the issuer, and in case of a conduit issue, the borrower, in order to satisfy the requirements of the Internal Revenue Code and the regulations issued thereunder for the bonds to be tax-exempt. It also describes the rules applicable to the investment of bond proceeds under federal tax law.

Substitutes: Tax Agreement; Arbitrage or Non-arbitrage Certificate.

Principal Drafter: Bond Counsel.

Parties: Issuer, Borrower.

Critical Provisions for Issuer Review: Varies greatly depending on type of issue, but always should review “use of proceeds” section in consultation with the bond counsel.

15.9 Closing Documents

Purpose: Contains the certificates, receipts, written directions and requests, requisitions and similar documents, which are delivered at the closing of an issue. These documents generally accomplish the following:

- (i) Document the factual representations required by the purchase contract and accuracy and completeness of expertized portions of the disclosure;
- (ii) Document compliance with the requirements of law and contract for the issuance of the bonds;
- (iii) Document the flow of funds at closing; and
- (iv) Instruct parties to take certain actions upon closing; i.e. deposit funds in accounts, record documents, file reports, release security, etc.

Substitutes: None.

Principal Drafter: Bond Counsel.

Parties: All parties to transaction.

Critical Provisions for Issuer Review: Accuracy of all amounts for receipt and deposit of funds, accuracy of representations, warranties and certifications. All requisitions should be reviewed to determine correctness of payments, deposits and transfers