

City of Pasadena, California

**DEBT MANAGEMENT POLICY
HANDBOOK**

*Department of Finance
Treasury Division*

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INTRODUCTION

The following policies are enacted in an effort to standardize and rationalize the issuance and management of debt by the City of Pasadena. 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.

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.

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 "sinks") 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.