CITY OF POWAY

DEBT MANAGEMENT POLICY

October 6, 2015

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City of Poway
Debt Management Policy

I. Introduction

The purpose of the City of Poway (the “City”) Debt Management Policy (the "Policy") is to ensure sound and uniform practices for issuing and managing bonds and other forms of indebtedness. This policy expands upon the City’s general Financial Policy, previously adopted on June 16, 2009.

Appendix A to these policies provides a glossary of key terms used in these policies or important for debt management. Appendix B reviews the key characteristics evaluated by bond rating agencies in reviewing municipal debt, and how Poway measures under this criteria.

II. Policy Objectives

The Policy objectives are as follows:

- To help maintain the financial stability of the City by ensuring that its long-term financing commitments are affordable and do not create undue risk or burden.
- To protect the City’s high credit rating and minimize the City’s borrowing costs.
- To meet the requirements of state and federal law and regulation, including federal requirements regarding disclosure.
- To incorporate best practices into the City’s issuance and administration of its indebtedness.

III. Scope of City Indebtedness

This Policy governs the issuance and management of all debt and lease financing activity by the City, including bonds issued through the Poway Public Financing Authority; the Authority is a joint powers authority of the City and its former redevelopment agency created to facilitate financing. The following are the types of debt that the City is likely to issue.

- **Voter-approved indebtedness**: The City can issue general obligation bonds with approval of 2/3 of those voting at an election. Such bonds would be repaid out of a supplemental property tax, levied based on the value of property. There are certain legal limits on the amount of general obligation bonds the City can issue, although they are quite high; based on its 2014-15 assessed valuation, the City could issue up to $320 million in general obligation bonds. To date, the City has not issued this form of debt. General obligation bonds would be an appropriate method of financing capital improvements of City-wide benefit, if 2/3 voter approval could be obtained.

The City could also seek 2/3 approval of a parcel or other special tax (levied on a basis other than assessed valuation) structured to secure bonds.

- **General Fund lease obligations**: Debt obligations secured by lease payments from a city's general fund do not require voter-approval under California law (the State Constitutional Debt Limit). Lease obligations can take the form of lease revenue bonds, certificates of participation or financing leases that are privately placed with a bank. There is no legal limitation on the amount of such debt, although there are practical budget limitations of debt affordability. The City has two financing lease obligations outstanding, both in the form of certificates of participation.

- **Cashflow borrowings**: the City can issue tax and revenue anticipation notes that are repaid out of current year revenues to smooth any temporary cash shortages. The City has not utilized this form of financing in the past.

- **Enterprise revenue debt**: Debt can be secured by the City's water and sewer enterprises, in the form of revenue bonds, certificates of participation, or State loans. The market requires that, if enterprise revenue debt is issued, the City maintain rates sufficient to pay operations and maintenance of the system, and provide a measure of coverage of debt service. The City has issued water revenue bonds in the past.

- **Assessment and Mello-Roos special tax bonds**: the City can form assessment districts, with majority property-owner approval, to finance projects that provide special benefit to the property. Similarly, property owners of undeveloped land can approve Mello-Roos special taxes to finance public improvements. Both forms have been used by the City in the past, although no such debt is currently outstanding. At the time any such debt is considered in the future, specific land-secured policies should be drafted for Council consideration, consistent with State law (for Mello-Roos districts) and best practices.

- **Tax allocation bonds**: The City's former redevelopment agency had the power to issue bonds secured by the property tax-increment generated by its project area, as well as enter into other debt-like obligations. With the dissolution of redevelopment, no such new obligations can be incurred. The City, acting as the redevelopment agency's successor agency, can refund outstanding debt for savings. The most recent bond refunding was successfully accomplished in calendar year 2015.

- **Conduit debt**: Cities can also issue tax-exempt bonds to lend the proceeds to certain non-profit corporations and other activities. The City has not issued such debt in the past, but may work with statewide authorities to facilitate such projects within the City.

IV. Debt Management Responsibility

The Director of Administrative Services/Treasurer is appointed as the City official responsible the following:

- Debt issuance and management, recognizing that assigned staff may be charged with the day-to-day responsibilities.

- Working with the City Manager, the Assistant City Manager, and other staff deemed appropriate in formulating the City's debt management plans, executing these plans, and ensuring the appropriate debt management.

- Keeping the City Council informed of City's debt-related activities through informational reports, briefings, Council meetings, or workshops.

V. Uses and Limits on Indebtedness

Debt provides a powerful tool for financing capital projects that are too large to accommodate as part of the annual budget, to share the cost of major improvements between current and future taxpayers or ratepayers, and to accelerate the delivery of a project that will generate savings greater than the cost of interest. On the other hand, debt service represents a fixed cost that will compete with other expenditures in the City's budget and cannot be deferred in any given year. In order to achieve the proper balance in its use of debt, the City will follow the following policy goals:

- Except to alleviate cash-flow timing issues within a fiscal year, the City will not use debt to finance recurring operating expenses. The City may consider use of debt in the event of an extraordinary expense, such as the financing of a major judgment.

- The City will plan for capital improvements and maintenance as part of its budgeting process, seeking to set funds aside in advance of need so that most capital projects can be financed on a "pay-as-you-go" basis. Debt financing will generally be reserved for extraordinary capital expenditures.

- Consistent with its high ratings, the City shall not incur obligations paid out of the General Fund that exceed six percent (6%) of General Fund expenditures. Debt that is backed by the General Fund but expected to be paid out of other revenues may be deducted from this calculation. This calculation of debt burden will be contained in any staff report recommending the approval of any such new obligations.

- The City will consider indebtedness secured by its utility enterprises in those instances where large capital investment is required and the use of debt allows for a pattern of smooth rate increases over time.

VI. Method of Sale

Debt can be sold at a public offering through the sale of bonds, either through a competitive or negotiated sale, or through a private placement with a bank or other institution. The best method of sale will be a reflection primarily on the type of security and market conditions. It is the City's preference to issue debt through a competitive sale. A negotiated sale will be considered for unusual credits, volatile markets, or when otherwise determined to be in the City's best interest. The basis for the recommendation for the method of sale will be included in any staff report recommending the approval of any such new obligations.

The City will consider privately placing its debt for small borrowings or in instances where difficult disclosure considerations or other special circumstances so warrant.

VII. Interfund Loans

In lieu of issuing bonds or otherwise borrowing from third-parties, there will be situations that the most appropriate means for the City to borrow money will be through a loan from a well-capitalized City fund. Such Interfund Loans can be seen as an alternative investment of temporarily surplus City funds, which normally would be invested at a short-term rate as part of the City's pooled investment program.

In approving any such Interfund Loan, the City Council will adopt a resolution that sets forth the terms of the loan, which will include the following:

- The interest rate that the loan will bear until repayment. Appropriate interest rates may be the rate that the investment pool is earning from time to time over the term of the loan, the rate of a Treasury security of an equivalent term of the loan, or a rate that reflects the additional risk or illiquidity of the loan to fully compensate the fund that provides the loan.

- The terms under which the loan will be repaid.

- If there is a possibility that the loan will be repaid from the proceeds of tax-exempt bonds, a statement of such expectations so as to satisfy the federal tax law requirements for reimbursement bonds.

VIII. Financing Professionals

A. Bond Counsel

The Director of Administrate Services/Treasurer, in consultation with the City Manager, will be responsible for recommending bond counsel, based on prior experience, recommendations or a request for proposal process, as he or she deems appropriate. The Director of Administrative Services/Treasurer will also determine whether to select another law firm to provide the services of disclosure counsel to draft the City's official statement, or to assign such duties to bond counsel.

B. Financial Advisor

The City will select a municipal financial advisor to serve as a general advisor to the City, to assist in the structuring of its debt offerings, to conduct its competitive bond sales, and to assist with a negotiated bond sale to ensure that interest rates are appropriate. The financial advisor will be selected through a request for proposals.

C. Underwriter

If the City elects to sell its debt through a competitive sale, the underwriter will be selected based on the best bid. At those times that the City decides to issue its debt through a negotiated sale, it will select one or more underwriters. Unless there are special circumstances, the underwriter of a negotiated sale will be chosen through a request for proposals.

D. Trustee

The Director of Administrative Services/Treasurer shall have the discretion to select a commercial banking firm as trustee, either through a request for qualifications process or by relying on existing banking relationships if deemed to be advantageous in advancing the City's debt management goals.

IX. Structuring Debt Financing

A. Term and Structure

Long-term debt financing of capital projects will be amortized over a period no longer than the useful life of the assets being financed, and in no event should exceed thirty years.

Debt Service will generally be structured to be level over the length of the bonds. Alternate debt structures may be used to wrap new debt around existing debt to create overall level debt service or to achieve other financial planning goals appropriate to the specific project.

The dates for which debt service is scheduled (typically semi-annually) will take into account the cash flows of the revenues that will service such debt. In most cases, debt service payments should not be due within the first three months of the fiscal year.

B. Debt Service Reserve Fund

To the extent required by the market or where the additional cost is less than the debt service savings afforded, the City may fund a debt service fund out of bond proceeds no greater than the amount allowed under federal tax law.

C. Capitalized Interest

Funding interest payments out of bond proceeds during construction is required for a lease revenue obligation where the leased asset is the project being financed. The City will consider leasing an existing municipal asset (an "asset transfer") in order to reduce or eliminate the need to capitalize interest. In other occasions, the City will consider capitalizing interest when it is appropriate to begin the payment of debt service after project completion.

D. Variable Rate Debt

To maintain a predictable debt service burden, the City will give preference to debt that carries a fixed interest rate. It may be appropriate to issue variable rate debt to diversify the City's debt portfolio, provide greater call flexibility, or improve the match of variable-rate assets (investments in the City's treasury) to liabilities. The City's cost for administering variable rate debt, including the renewal or replacement of bank facilities, should be considered when comparing fixed and variable rate debt.

E. Disclosure

For all public sales of debt, the City will retain the services of disclosure counsel (who may also serve as bond counsel) to prepare the Official Statement to be used in connection with the offering and sale of debt. Appropriate staff will be asked to review this document to ensure that it is accurate and does not fail to include information that such staff and officials believe may be material to an investor. The City will make every effort to ensure the fullest disclosure possible in the City's disclosure documents. A Preliminary Official Statement will be released to the market only after the completion of the "due diligence" meetings with appropriate staff and approval in form by the Council.

F. Credit Ratings

The Director of Administrative Services/Treasurer, in consultation with the Financial Advisor and other members of the financing team, will evaluate and make recommendations regarding the number of credit ratings to seek on any given bond issue. The City will work to maintain its current high credit rating; the Director of Administrative Services/Treasurer will periodically communicate with the agencies rating the City's debt so that they will remain well-informed.

G. Credit Enhancement

The City will consider the use of credit enhancements such as bond insurance on a case-by-case basis. The cost-benefit of insurance will be evaluated through the first optional call date, recognizing that most municipal bonds are refunded prior to maturity. The City will consider the use of a surety policy in lieu of a cash funded reserve, but in doing so will consider the cost of replacing that surety at the time of a refunding.

X. Refunding Bonds

In order to provide for the potential refunding of its bonds in the future, and absent compelling reasons to the contrary, the City will structure its bond issues with an optional call no longer than ten years from the date of issuance. Such compelling reasons to deviate from this policy would be a taxable bond issue, where the additional interest cost required for an optional call may outweigh the likely benefits. When structuring its bond issues, the City will take into account the coupon structure of its debt (i.e., discount bonds or premium bonds that mature after the call date) and its impact on its option to execute a refunding.

The City will regularly review its outstanding debt portfolio to identify opportunities to achieve net economic benefits from refunding its bonds. Recognizing that the City's ability to refund its debt is limited, because of federal tax law constraints on advance refundings and the market practice of making most fixed-rate bond issues non-callable for their first ten years, the City will seek to deploy its refunding options prudently. At a minimum, the City will seek to achieve net present value ("NPV") savings equal to at least three percent (3%) of the par amount of the bonds that are refunded. For advance refundings, the threshold goal will be five percent (5%) NPV savings. A second limiting factor on advance refundings will be that negative arbitrage (the amount of additional funds that need to be deposited into an escrow to make up for interest earnings being less than the interest on the defeased bonds) will be no greater than half the amount of the NPV savings.

When it is practical to consider a partial refunding, the analysis will be performed on a maturity-by-maturity basis. Other factors that may be considered are the length of the period before the call date (the longer the period the higher the savings target should be), the length of time after the call date (savings are more difficult to realize for a short maturity, and thus the target could be lower), and any other factors that assist in considering the value of a call option.

The City may also consider a refunding for a non-economic purpose, including the retirement of an indenture for more desirable covenants, a change in tax status, or to change the type of debt instrument.

XI. Debt Administration

The Director of Administrative Services/Treasurer and his or her staff shall be responsible for ensuring that the City's debt is administered in accordance with its terms, federal and State law and regulations, and best industry practices.

A. Tax-Exemption

Tax-exempt bond issues are subject to various IRS rules and regulations regarding the use of bond proceeds. The City will make sure that the use of facilities financed with tax-exempt bonds are not used for ineligible private activities, and will consult with bond counsel whenever it identifies a change in use, enters into a long-term contract involving the project, or otherwise undertakes an action that could change the tax-exempt status of its bonds.

The City will retain an arbitrage rebate consultant to assist in calculating any earnings on bond proceeds in excess of the rate on its bonds, and to calculate whether arbitrage should be rebated to the Federal Government.

B. Continuing Disclosure

Under federal law, the City must commit to provide continuing disclosure to investors in any of its debt that is sold to underwriters to be offered to the public. All existing and future City debt should be compliant with the requirements of the Continuing Disclosure Certificates executed at the time of issuance, including the annual filing with the MSRB's Electronic Municipal Market Access ("EMMA") web site of the City's Comprehensive Annual Financial Report and any other required reports; the filing of notices of the material events set out in the Continuing Disclosure Certificates; and the filing of any voluntary disclosures deemed material. All such filings will be made within the time requirements set forth in the Continuing Disclosure Certificates.

The City may retain a consultant to assist in preparing and filing required reports and notices.

C. Investment of Bond Proceeds

Investments of bond proceeds shall generally be consistent with the City's Investment Policy as modified from time to time, and with the requirements contained in the governing bond documents.

D. Annual Reporting

A report summarizing the City’s indebtedness will be prepared at least annually. Such report can be included as part of the City’s proposed budget.

XII. Conclusion

This Policy is intended to guide and regulate the City's issuance of debt. This policy should be reviewed and updated periodically to reflect changes in the market, the identification of other best practices, and to incorporate the City’s own experience or changing circumstances.

While adherence to this Policy is generally required, it is recognized that changes in the capital markets, the City’s needs and other unforeseen circumstances may from time to time produce situations that are not covered by the Policy or will require modifications or exceptions to best achieve policy goals. Any deviations from this policy recommended by staff should be highlighted in the staff report transmitting the resolution for approval of the financing.

APPENDIX A

GLOSSARY OF TERMS

Advance Refunding: A refunding that occurs more than 90 days in advance of the first optional redemption or "call" date of the refunded bonds. Although the prior bonds remain outstanding, all covenants and restrictions of the refunded bond indenture are extinguished as a result of the Defeasance of the refunded bonds. Under current IRS regulations, tax-exempt bonds issued after 1985 are permitted only one Advance Refunding.

Arbitrage: With respect to municipal bonds, arbitrage is the profit made by issuing bonds bearing interest at tax-exempt rates, and investing the proceeds at materially higher taxable yields. The Internal Revenue Code limits the opportunity for borrowers to retain such investment profits; in most cases, the borrower must calculate such profits and rebate them to the IRS every five years. Arbitrage administration is one of the City's on-going debt management responsibilities.

Basis Point: Yields on bonds are usually quoted in increments of Basis Points or "bps." One Basis Point is equal to one-one hundredth (1/100) of one percent. For example, the difference between 5.00% and 5.50% is 50 Basis Points or bps.

Bond Counsel: A law firm retained by the bond issuer to give a legal opinion that the bond issuer is authorized to issue the proposed securities, the bond issuer has met all legal requirements necessary for issuance, and interest on the proposed securities will be exempt from federal income taxation. Usually, Bond Counsel will prepare authorizing resolutions and ordinances, trust indentures and other bond documents, with the possible exception of the Official Statement (see Disclosure Counsel).

Bond Insurance: An insurance policy which guarantees the timely payment of principal and interest, of either an entire bond issue or on one or more specified maturities. In exchange for payment of the Bond Insurance premium, a higher Credit Rating is assigned to the insured bonds, and a lower cost of funds is attained.

California Debt and Investment Advisory Commission (CDIAC): A State commission established to provide oversight with respect to public debt and investment activities. It serves as the State's clearinghouse for information on public debt issuance and local investment practices. CDIAC also provides policy guidance on debt and investment matters.

Capital Appreciation Bond (CABs): A bond on which interest is not payable until maturity (or earlier redemption), but compounds periodically to accumulate to a stated maturity amount. These bonds are sometimes misnamed zero coupon bonds. The alternative to a CAB is the more common Current Interest Bond.

Capitalized Interest: Capitalized Interest is a portion of the proceeds of an issue that is set aside to pay interest on the bonds for a specified period of time. Interest is commonly capitalized during the construction period of a revenue-producing project or a project financed with the proceeds of lease revenue bonds, where the facility securing the lease payments must be available for use and occupancy before lease payments may commence.

Certificates of Participation (COPs): A certificate (which looks very much like a bond) representing an undivided interest in the payments made by a public agency pursuant to a contract, usually a financing lease (when paid out of the General Fund) or an installment purchase agreement (when secured by an Enterprise or other Special Fund). Typically used in instances where State law does not provide “bonding” authority that meets an agency’s objectives. The interest component of the installment payment is treated as if it were a debt under federal tax law, and as a result, the interest component may be treated as tax-exempt interest.

Competitive Sale: The sale of a new issue of bonds by an issuer through a bidding process where Underwriters are awarded the bonds on the basis of offering the lowest cost of funds for the issuer, usually measured on a True Interest Cost basis. The bid parameters for the public sale are established in the notice of sale or notice inviting bids.

Continuing Disclosure Certificate or Agreement: A commitment entered into by a bond issuer to the underwriter, required by SEC Rule 15(c)2-12, to provide continuing disclosure of specific information.

Credit Ratings: Evaluations of the credit quality of bonds made by independent ratings services such as Moody’s Investors Service, Standard & Poor’s Ratings Services and Fitch Ratings. Credit Ratings are intended to measure the probability of timely repayment of principal and interest on municipal securities.

Current Interest Bonds: Bonds that pay interest periodically until maturity, typically every six months.

Current Refunding: A refunding of bonds within 90 days of the bond’s first optional redemption or “call” date. Federal tax law does not limit the number of Current Refundings of any bond, but most bonds can be optionally called only after ten years based on the terms of their issuing documents.

Debt Service: The sum of principal and interest due on outstanding debt. Debt Service is usually computed on a bond year (from the date of issuance) or fiscal year basis.

Debt Service Reserve Fund: The fund in which moneys are placed to be used to pay Debt Service if the debt repayment source (e.g., lease payments) is insufficient.

Defeasance: The structuring of a portfolio of non-callable government securities or a deposit of cash into a fund irrevocably committed to the payment of a series of bonds; the principal of and interest earnings on the investment portfolio will be sufficient to pay Debt Service on the outstanding bonds until the designated redemption date and then sufficient to call the bonds. The rights and interest of the holders of the outstanding bonds and of their lien on revenues is terminated in accordance with the bond documents upon the occurrence of a Defeasance. Defeasance usually occurs through the issuance of refunding bonds and the creation of an escrow.

Derivative: A contract whose value is based on the performance of an underlying financial asset, index or other investment. An example is an Interest Rate Swap, an agreement between two parties to exchange future flows of interest payments calculated on a different basis.

Disclosure: From the perspective of the bond issuer, Disclosure means the dissemination of accurate and complete information material to an existing or proposed bond issuance, which an investor would be likely to consider important in making an investment decision. Failure to provide adequate disclosure violates the anti-fraud provisions of federal securities law. The material facts pertinent to a new offering of bonds are disclosed in the Official Statement.

Disclosure Counsel: A law firm retained by the bond issuer to prepare the Official Statement. Often the same firm that serves as Bond Counsel also serves as Disclosure Counsel.

Enterprise Fund: A Special Fund created to account for the operations of a municipal operation that earns revenues, such as a water or sewer system.

Financial Advisor: A consultant which advises the bond issuer on matters such as bond structure, timing, marketing, pricing, documentation and Credit Ratings. The consultant may also provide non-bond related advice relating to capital planning and investment management. Financial Advisors must be registered as an independent registered municipal advisor ("IRMA") with the SEC.

Fixed Rate Debt: A borrowing wherein interest is established at a fixed rate of interest for the life of the obligation.

General Fund: the City's general operating fund, used to account for general taxes such as property and sales tax, and other resources that are not required to be accounted for in another fund.

General Obligation Bond: A true indebtedness of the City under the State Constitution, approved by 2/3 of the voters, and secured by an ad valorem property tax levy based on the assessed value of property.

Interfund Loan: A loan from one of the City's funds to another, used as an alternative to borrowing from a third-party such as through a bond issue. The terms of repayment may vary based on the particular circumstances.

Municipal Securities Rulemaking Board (MSRB): An independent self-regulatory organization established by the Securities Acts Amendments of 1975, which is charged with primary rulemaking authority over brokers and financial advisors in municipal securities.

Negotiated Sale: The sale of a new issue of bonds whereby the issuer selects the Underwriters in advance and negotiates the terms of the bonds, including coupons, interest rates, redemption provisions, and the Underwriter's Discount, at the time of sale.

Negative Arbitrage: Issuers often deposit the proceeds from the sale of bonds into funds until they are expended, including construction funds, Debt Service Reserve Funds and escrow funds to fund Defeasances. Depending on market conditions, these proceeds are often invested at a rate that is lower than the cost of borrowing, resulting in a net cost to the issuer (financed through the sale of additional bonds) during the expenditure period. This scenario is known as negative arbitrage.

Official Statement: A document published by the bond issuer, and usually prepared by Disclosure or Bond Counsel, which discloses material information on a new bond issue, including the purpose of the issue, source of repayment, bond covenants, and the financial, economic, demographic and legal characteristics of the bond issuer. An Official Statement is deemed a "Preliminary Official Statement" prior to the determination of the interest rates on the bond issue, but is final in all other respects at the time it is circulated in its preliminary form prior to the sale of the bonds.

Optional Redemption Provisions: Terms set out in the bond documents which give the bond issuer the right to redeem or "call" all or a portion of an outstanding issue of bonds, prior to their stated dates of maturity at a specified price. Under current market conventions, most bonds are callable after ten years at par, or their face value.

Private Placement: A sale in which the bonds are sold directly to institutional or private investors, usually banks, rather than through a public bond offering.

Revenue Bond: A bond which is payable from a specific source of revenue. Revenue bonds can be secured by a Special Fund, including an Enterprise Fund such as water or wastewater. “Lease revenue bonds,” payable from General Fund appropriations, are technically a form of revenue bond.

SEC Rule 10b-5: A regulation of the Securities and Exchange Commission, adopted pursuant to the Securities and Exchange Act of 1934, which makes it unlawful for any person to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact, or to omit a material fact necessary to make statements made, in the light of the circumstances under which they were made, not misleading; or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. City representatives execute a 10b-5 certificate as part of a bond closing.

SEC Rule 15(c)2-12: A regulation of the SEC which requires Underwriters participating in primary offerings of most municipal securities to obtain, review, and distribute to investors copies of the issuer’s Disclosure documents, and to obtain and review a copy of an Official Statement deemed near final by an issuer of the securities. SEC Rule 15(c)2-12 also requires that Underwriters participating in a bond offering obtain from the issuer a written Continuing Disclosure Agreement to provide continuing disclosure with respect to those bonds.

Special Fund: A fund whose uses are limited and does not receive general taxes. An Enterprise Fund is one kind of Special Fund.

Special Taxes: Under the State Constitution, taxes levied on a basis other than the value of property, which must be approved by 2/3 of voters.

State Constitutional Debt Limitation: Article 16, Section 18 of the State Constitution, originally added in 1879, limits a city’s “indebtedness” by requiring a 2/3 vote and the levy of a property tax. Over the years, the State Supreme Court has found a number of exceptions to the debt limit, including for leases (payments are contingent on the use of a property), Special Funds (such as utility enterprises, payable out of revenues other than taxes), short-term indebtedness that does not bridge fiscal years (such as Tax and Revenue Anticipation Notes), and “obligations imposed by law” (such as pensions and judgments).

Takedown: The sales commission paid to Underwriters in connection with the sale of bonds by an issuer, typically expressed in dollars per thousand dollar bond increments (e.g. $5.00 per $1,000 or $5.00 per "bond"). Takedown is the largest component of the Underwriter's Discount.

Tax Certificate: A closing document for a bond transaction prepared by Bond Counsel setting forth the various requirements under federal tax law related to the bonds, including matters related to expenditure and use of funds and arbitrage rebate, among other provisions.

Tax and Revenue Anticipation Notes or "TRANS": A short-term borrowing mechanism that permits a municipal issuer to fund cash flow deficits within a fiscal year. TRANs are typically issued at the beginning of a fiscal year and repaid at the end of the same fiscal year.

True Interest Cost: The rate, compounded semi-annually, necessary to discount the amounts payable on the respective principal and interest payment dates, to the purchase price received on the closing date of the bond issue. This is the most common way that bond interest cost is calculated.

Trustee: A banking institution, typically through a corporate trust department, which administers the funds specified in the trust indenture or agreement and implements the remedies provided in case of default. The Trustee acts on behalf of the bondholders based on the specific requirements in each trust indenture.

Underwriter: A dealer which purchases a new issue of bonds for resale to investors, either by negotiation with the issuer, or by award on the basis of a competitive bid.

Underwriter's Counsel: A law firm retained by the Underwriter to represent their interests in connection with the negotiated purchase of a new issue of bonds.

Underwriter's Discount: The difference between the price the Underwriter pays the bond issuer and the original reoffering price to the public. Also referred to as "Gross Spread" or "Underwriter's Spread." It includes the management fee (if any), expenses, and sales commissions (referred to as Takedown).

Variable Rate Debt: A borrowing wherein interest changes at intervals according to an index or formula, or is periodically (e.g., daily, weekly or monthly) reset at the market clearing rate. This is also known as floating rate debt.

APPENDIX B

CREDIT RATINGS

Credit ratings are an assessment by independent agencies as to the likelihood that an entity's debt will be paid in full and on time. The key agencies that rate municipal bonds are Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings. Each assigns a letter grade with appropriate modifiers to express their opinion, and publishes a written report explaining the basis for their ratings. While the purpose of a rating is to assist underwriters and bond investors in determining the appropriate pricing of a security relative to other securities offered in the market, the opinions of the rating agencies can provide objective information that is useful to the public agency in evaluating its debt and other financial practices.

Traditionally, municipal bond ratings have reflected four key credit factors: the economic base, financial operations, debt burden and management. Following the credit crises of 2008, all rating agencies re-evaluated their rating practices, and began publishing more specific and objective criteria.

The City of Poway is currently rated by one agency, Standard & Poor's. Its general "issuer credit rating" is at the highest level—AAA; that is the rating the City's general obligation bonds would receive if it were ever to issue such debt. The City's lease revenue certificates of participation, which are paid out of General Fund appropriations, are rated one level lower, at AA+, reflecting the weaker security of such debt.

This appendix reviews the City of Poway's credit in light of S&P's published rating criteria, which has been expanded to include seven basic categories (percentages reflect the weighting this criteria is given in assigning the rating).

Institutional framework (10%). This category assesses the legal and practical environment in which the local agency operates. Most California cities are scored at the same level, as "strong," which is the second-highest rating. This assessment incorporates the risk of changes from voter initiatives and the limitations on a city's ability to raise revenues without voter approval.

Economy (30%). The economic score assesses both the health of the tax base as well as the likelihood of additional service demands resulting from economic deterioration. Rating agencies tend to rely on data such as per capita income and assessed valuation, due to the availability of these statistics at the local level and their correlation with overall economic activity and local government revenues.

Poway scores well in this area by S&P, who observes that the City “has economic metrics significantly stronger than those of the nation as a whole and has suffered mild effects from the recent recession. Median household effective buying income is very strong... and per capita market value (a measure of wealth) is extremely strong.” The rating also takes into account the strength of the broader regional economy, which is a strength for Poway, since S&P finds that the “Metropolitan San Diego economic base... has a very strong income profile and unemployment rate that tracks below the national average.”

Management (20%). While the quality of local management is a key factor in credit, it is one of the most difficult for a rating agency to assess. S&P notes in its criteria that managerial decisions, policies, and practices apply directly to the government's financial position and operations, debt burden, and other key credit factors. The agency adopted a Financial Management Assessment methodology to evaluate this factor, focusing on the policies that the agency has adopted to govern its budgeting, long-term financial planning, financial reserves and debt and investment management. In its last rating review, S&P considered “the city's management practices "good" under our financial management assessment (FMA) methodology, [indicating] that practices exist in most areas, although not all might be formalized or regularly monitored by governance officials.” Their rating report noted that “although the city's financial policies address general debt guidelines that include an emphasis on pay-as-you-go financing, the city does not have a comprehensive debt management policy.” One of the motivations for the drafting of this debt policy was to improve S&P’s scoring of the City in this area.

Budgetary flexibility (10%). The budgetary flexibility score measures the degree to which the government can look to additional financial flexibility in times of stress. Available fund balance, as reported in an agency’s annual financial report, is a key factor for this criterion. Poway scores as very strong in this area.

Liquidity (10%). This criterion is similar to budgetary flexibility, except it is based on cash and cash equivalents, rather than the modified accrual accounting that determines fund balance. Poway is very strong in this area as well.

Budgetary performance (10%). This criteria looks at the City’s ability to generate positive operations; spending less than its revenues in most years. S&P noted the City’s ability to maintain a generally balanced budget throughout the recession.

Debt and contingent liabilities (10%). While the weight given to the amount of a City’s debt has been reduced under S&P’s revised criteria, it is still an important factor. The rating agencies look at both formal debt like bonds, as well as other liabilities such as pension and other retirement liabilities such as health care. Among the measures that S&P uses is direct governmental debt (including pensions) as a percent of revenues, and debt service as a percent of expenditures. With only two general governmental debt issues outstanding (certificates of participation sold in 2005 and 2012), only about 3% of the City's expenditures are for debt service. S&P's criteria scores a debt service burden of under 8% in its strongest category; the Debt Policy recommends a maximum of 6% of General Fund expenditures. S&P does note that "the city's combined direct and overlapping debt [the debt of other agencies that share the tax base] is moderate relative to [assessed] market value, at 5.2%, but high relative to its population, at $8,671 per capita." Much of this debt consists of former redevelopment agency debt and debt of the Poway Unified School District.