CITY OF SAN LUIS OBISPO

CAPITAL FINANCING & DEBT MANAGEMENT

October 2022

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Introduction

POLICY STATEMENT

The City of San Luis Obispo (City) will maintain, at all times, debt management policies that are fiscally prudent, consistent with State and Federal law, and that reflect the most opportune financing strategies to deliver on the needs and goals of the community and the City organization.

This Debt Management Policy establishes objectives, parameters, and guidelines for responsibly issuing and administering the City's debt. Prudent management of the City's debt program is necessary to achieve cost-effective access to the capital markets and demonstrates a commitment to long-term financial planning and sustainability.

DEBT MANAGEMENT OBJECTIVES

This policy sets forth key objectives for the City in issuing and administering the City's debt, which are to:

- Maintain the City's sound financial position.
- Minimize debt service and issuance cost.
- Maintain access to cost-effective borrowing.
- Achieve and maintain highest reasonable credit rating.
- Ensure full and timely repayment of debt.
- Maintain full and complete financial disclosure and reporting including voluntary disclosures.
- Ensure compliance with State and Federal laws and regulations.

SCOPE

This policy establishes the framework for when the City of San Luis Obispo should consider issuing debt and the overall acceptable debt burden. Long-term debt is an effective way to finance capital improvements by matching the term of the debt with the useful life of the asset being financed. Properly managed debt provides flexibility in current and future operating budgets and provides the City with the long-term assets required to deliver services, programs, and public infrastructure to the community. The City recognizes that effective debt management practices require a comprehensive Debt Management Policy that details the use of capital debt to support the capital infrastructure in the community while maintaining a stable and prudent fiscal outlook.

Consideration of Capital Financing

1. The City will consider the use of debt financing only for one-time capital improvement projects and only under the following circumstances:

   a. When the project's useful life will exceed the term of the financing.
   b. When project revenues or specific resources will be sufficient to service the long-term debt.

2. Debt financing will not be considered appropriate for any recurring purpose such as operating and maintenance expenditures. The issuance of short-term instruments such as revenue, tax or bond anticipation notes is excluded from this limitation. (See Investment Policy)

3. Capital improvements will be financed primarily through user fees, service charges, assessments, special taxes or developer agreements when benefits can be specifically attributed to users of the facility. Accordingly, development impact fees should be created and implemented at levels sufficient to ensure that new development pays its fair share of the cost of constructing necessary community facilities and public infrastructure. *For Community Facilities Districts please see section F.*

4. Transportation impact fees are a major funding source in financing transportation system improvements. However, revenues from these fees are subject to significant fluctuation based on the rate of new development. Accordingly, the following guidelines will be followed in designing and building projects funded with transportation impact fees:

   a. The availability of transportation impact fees in funding a specific project will be analyzed on a case-by-case basis as plans and specification or contract awards are submitted for City Manager or Council approval.

   b. If adequate funds are not available at that time, the Council will make one of two determinations:

      1. Defer the project until funds are available.
      2. Based on the high-priority of the project, advance funds from the General Fund, which will be reimbursed as soon as impact fee funds become available. Repayment of General Fund advances will be the first use of transportation impact fee funds when they become available.

5. The City will use the following criteria to evaluate pay-as-you-go versus long-term financing in funding capital improvements:

   a. Factors Favoring Pay-As-You-Go Financing

      1. Current revenues and adequate fund balances are available, or project phasing can be accomplished.
      2. Existing debt levels adversely affect the City's credit rating.
      3. Market conditions are unstable, present difficulties in marketing, and would yield unfavorable financing terms.

   b. Factors Favoring Long-Term Financing

      1. Revenues available for debt service are deemed sufficient and reliable so that long-term financings can be marketed with investment grade credit ratings.

      2. The project securing the financing is of the type which will support an investment grade credit rating.

      3. Market conditions present favorable interest rates and demand for municipal bonds and yield favorable terms & conditions.
      4. A project is mandated by state or federal requirements, and resources are insufficient or unavailable.

5. The project is immediately required to meet or relieve capacity needs and current resources are insufficient or unavailable.

6. The life of the project or asset to be financed is 10 years or longer.

7. Vehicle leasing when market conditions and operational circumstances present favorable opportunities.

Designated Bonds

1. The City will consider the use of designated bonds such as Green Bonds, Sustainable Bonds, Social Bonds, or other alternatively designated bonds whenever advantageous and under the following circumstance:
   a. The City has determined the intended benefits, associated challenges, and cost fit with the goals and objectives set forth;
   b. The bonds support and respond to market demands for sustainable development (e.g. infrastructure, environmental improvements, and social benefit projects).
   c. When such an issuance allows the City to attract a broader investor base, media attention, and enhance resident engagement.

2. The City will use the Green Bond Principles as a framework to promote the role that debt capital markets can play in financing progress toward environmental and social sustainability.
   a. Use of Proceeds: allocating the full amount of the net proceeds of bonds to eligible green projects a defined by the Green Bond Framework;
   b. Project Evaluation and Selection: Using clear "green" criteria, as defined by the issue, to select projects for funding;
   c. Management of Proceeds: the City will track green bond proceeds and will review project expenditures to identify the eligible project cost that best correspond with the intended use.
   d. Reporting: Annually, until the Green Bonds proceeds are fully allocated, the City will report the use of the proceeds to demonstrate compliance with the intended use.

3. The City will ensure that the Designated Bonds are consistent with the intrinsic Environmental, Social, And Governance values of the City such as Diversity, Equity, and Inclusion (DEI) as well as with the United Nations Sustainable Development Goals (SDG).

   a. ***SDG 8: Decent Work and Economic Growth,*** which includes targets to achieve higher levels of economic productivity through diversification, technological upgrading, and innovation
   b. ***SDG 9: Industry, Innovation, and Infrastructure***, which includes targets to upgrade infrastructure and retrofit industries to make them sustainable, with increased resource-use efficiency and greater adoption of clean and environmentally sound technologies and industrial processes.
   c. ***SDG 10: Reduced Inequalities***, which includes targets for reducing inequalities in income as well as those based on age, sex, disability, race, ethnicity, origin, religion or economic or other status within a country.
   d. ***SDG 11: Sustainable Cities and Communities***, which include targets to provide access to safe, affordable, accessible and sustainable transport systems for all, and

improving road safety. As well as targets to ensure access to safe and affordable housing and basic services.

e. ***SDG 12: Responsible Consumption and Production,*** which includes targets to encourage companies, especially large and transnational companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle.
f. ***SDG 13: Climate Action*****:** which includes targets to strengthen resilience and adaptive capacity to climate-related hazards and natural disasters

2. The City will seek to qualify its designated bonds to provide detail to investors on the designated eligibility criteria for the use of proceeds on a case-by-case basis, using at least one of the following:

   a. Third Party Assurance: In which a certified company will create assurance reports that state whether the issuance is aligned with a reputable international framework
   b. Second Party Opinion (SPOs): In which an outside entity will provide an assessment of the designated bond framework, analyze eligible projects/assets, and provide a sustainability "rating", giving a qualitative indication of aspects of the issuer's framework and planned allocation of proceeds
   c. Green Bond Rating: In which a number of rating agencies assess the bond's alignment with the Green Bond Principles and the integrity of its green credentials

Debt Management

1. The City will not obligate the General Fund to secure long-term financings except when marketability can be significantly enhanced.

2. An internal feasibility analysis will be prepared for each long-term financing which analyzes the impact on current and future budgets for debt service and operations. This analysis will also address the reliability of revenues to support debt service.

3. The City will generally conduct financings on a competitive basis. However, negotiated financings may be used due to market volatility or the use of an unusual, complex financing or security structure, or the market conditions yielding more favorable terms in a negotiated financing.

4. The City will seek an investment grade rating (Baa/BBB or greater) on any direct debt and will seek credit enhancements such as letters of credit or insurance when necessary for marketing purposes, availability and cost-effectiveness.

5. The City will monitor all forms of debt annually coincident with the City's Financial Plan preparation and review process and report concerns and remedies, if needed, to the Council.

6. The City will diligently monitor its compliance with bond covenants and ensure its adherence to federal arbitrage regulations.

7. The City will maintain good, ongoing communications with bond rating agencies about its financial condition. The City will follow a policy of full disclosure on every financial report and bond prospectus (Official Statement) and continue its voluntary disclosures.

Debt Capacity

1. ***General Purpose Debt Capacity.*** The City will carefully monitor its levels of general-purpose debt. Because the City's general-purpose debt capacity is limited, it is important that the City only use general purpose debt financing for high-priority projects when it cannot reasonably use other financing methods for two key reasons:

   a. Funds borrowed for a project today are not available to fund other projects tomorrow.
   b. Funds committed for debt repayment today are not available to fund operations in the future.

   In evaluating debt capacity, general-purpose annual debt service payments should generally not exceed 10% of General Fund revenues; and in no case should they exceed 15%. Further, direct debt will not exceed 2% of assessed valuation; and no more than 60% of capital improvement outlays will be funded from long-term financings.

2. ***Enterprise Fund Debt Capacity.*** The City will set enterprise fund rates at levels needed to fully cover debt service requirements as well as operations, maintenance, administration and capital improvement costs. The ability to afford new debt for enterprise operations will be evaluated as an integral part of the City's rate review and setting process.

Independent Disclosure Counsel

The following criteria will be used on a case-by-case basis in determining whether the City should retain the services of an independent disclosure counsel in conjunction with specific project financings:

1. The City will generally not retain the services of an independent disclosure counsel when all of the following circumstances are present:

   a. The revenue source for repayment is under the management or control of the City, such as general obligation bonds, revenue bonds, lease-revenue bonds or certificates of participation.
   b. The bonds will be rated or insured.

2. The City will consider retaining the services of an independent disclosure counsel when one or more of following circumstances are present:

   a. The financing will be negotiated, and the underwriter has not separately engaged an underwriter's counsel for disclosure purposes.

b. The revenue source for repayment is not under the management or control of the City, such as land-based assessment districts, tax allocation bonds or conduit financings.
c. The bonds will not be rated or insured.
d. The City's financial advisor, bond counsel, or underwriter recommends that the City retain an independent disclosure counsel based on the circumstances of the financing.

Land-Based Financings

1. ***Public Purpose.*** There will be a clearly articulated public purpose in forming an assessment or special tax district in financing public infrastructure improvements. This should include a finding by the Council as to why this form of financing is preferred over other funding options such as impact fees, reimbursement agreements, or direct developer responsibility for the improvements.

New development should generally be expected to "pay its own way," (i.e., provide funding through one mechanism or another that funds its "proportional share" of public improvement and infrastructure costs and ongoing operations and maintenance costs).

1. The City will consider the use of City-based funding sources to fund public facility and infrastructure improvements that provide for the health, safety and welfare of existing and future residents and/or provide measurable economic development and fiscal benefits. In evaluating whether the City will use city-based funding sources, the following evaluation criteria should be considered:
   a. Significant public benefit, demonstrated by compliance with and furtherance of General Plan goals, policies, and programs
   b. Alignment with the Major City Goals and other important objectives in place at the time of the application
   c. Head of Household Job Creation
   d. Housing Creation
   e. Circulation/Connectivity Improvements
   f. Net General Fund fiscal impact

2. The City generally will not fund or offer public financing for infrastructure improvements that confer only private benefit to individual property owners or development projects.

3. The City shall seek continuity (or improvements to) existing levels of municipal service by assuring adequate funding for the City's operation, maintenance and infrastructure replacement costs."

2. ***Eligible Improvements.*** Except as otherwise determined by the Council when proceedings for district formation are commenced, preference in financing public improvements through a special tax district shall be given for those public improvements that help achieve clearly identified community facility and infrastructure goals in accordance with adopted facility and infrastructure plans as set forth in key policy documents such as the General Plan, Specific Plan, Facility or Infrastructure Master Plans, or Capital Improvement Plan.

Such improvements include study, design, construction and/or acquisition of:

a. Public safety facilities.
b. Water supply, distribution and treatment systems.
c. Waste collection and treatment systems.
d. Major transportation system improvements, such as freeway interchanges; bridges; intersection improvements; construction of new or widened arterial or collector streets (including related landscaping and lighting); sidewalks and other pedestrian paths; transit facilities; and bike paths.
e. Storm drainage, creek protection and flood protection improvements.
f. Parks, trails, community centers and other recreational facilities.
g. Open space.
h. Cultural and social service facilities.
i. Other governmental facilities and improvements such as offices, information technology systems and telecommunication systems.

School facilities will not be financed except under appropriate joint community facilities agreements or joint exercise of powers agreements between the City and school districts.

3. ***Active Role.*** Even though land-based financings may be a limited obligation of the City, it will play an active role in managing the district. This means that the City will select and retain the financing team, including the financial advisor, bond counsel, trustee, appraiser, disclosure counsel, assessment engineer and underwriter. Any costs incurred by the City in retaining these services will generally be the responsibility of the property owners or developer and will be advanced via a deposit when an application is filed; or will be paid on a contingency fee basis from the proceeds from the bonds.

4. ***Credit Quality.*** When a developer requests a district, the City will carefully evaluate the applicant's financial plan and ability to carry the project, including the payment of assessments and special taxes during build-out. This may include detailed background, credit and lender checks, and the preparation of independent appraisal reports and market absorption studies. For districts where one property owner accounts for more than 25% of the annual debt service obligation, a letter of credit further securing the financing may be required.

5. ***Reserve Fund.*** A reserve fund should be established in the lesser amount of: the maximum annual debt service; 125% of the annual average debt service; or 10% of the bond proceeds.

6. ***Value-to-Debt Ratios.*** The minimum value-to-debt ratio should generally be 4:1. This means the value of the property in the district, with the public improvements, should be at least four times the amount of the assessment or special tax debt. In special circumstances, after conferring and receiving the concurrence of the City's financial advisor and bond counsel that a lower value-to-debt ratio is financially prudent under the circumstances, the City may consider allowing a value-to-debt ratio of 3:1. The Council should make special findings in this case.

7. ***Appraisal Methodology***. Determination of value of property in the district shall be based upon the full cash value as shown on the ad valorem assessment roll or upon an appraisal by an independent Member Appraisal Institute (MAI). The definitions, standards and assumptions to be used for appraisals shall be determined by the City on a case-by-case

basis, with input from City consultants and district applicants, and by reference to relevant materials and information promulgated by the State of California, including the Appraisal Standards for Land-Secured Financings prepared by the California Debt and Investment Advisory Commission.

8. ***Capitalized Interest During Construction.*** Decisions to capitalize interest will be made on case-by-case basis, with the intent that if allowed, it should improve the credit quality of the bonds and reduce borrowing costs, benefiting both current and future property owners.

9. ***Maximum Burden.*** Annual assessments (or special taxes in the case of Mello-Roos or similar districts) should generally not exceed 1% of the sales price of the property; and total property taxes, special assessments and special taxes payments collected on the tax roll should generally not exceed 2%.

10. ***Benefit Apportionment.*** Assessments and special taxes will be apportioned according to a formula that is clear, understandable, equitable and reasonably related to the benefit received by—or burden attributed to—each parcel with respect to its financed improvement. Any annual escalation factor should generally not exceed 2%.

Development Impact Fees Guidelines and Policies

Development impact fees are one-time fees levied on new development, typically levied at the time building permits are issued, to fund a range of the City's public facilities and infrastructure. Such fees are levied both on a citywide basis as well as for specific areas (e.g., the Specific Plan Areas). The levy of development impact fees is regulated by the State's Mitigation Fee Act (Government Code Section 66000 et seq.).

1. Development impact fees should be set, consistent with the statutory "nexus" analysis and findings, to fund new development's proportional share of public facility and infrastructure costs.

2. Improvements funded by development impact fees should be referenced generally in the appropriate planning documents (e.g., General Plan, Specific Plans, etc.) and reflected in the City's Capital Improvement Program.

3. An exception to this policy may be created by a development agreement between the City and a private developer. In this case public investments are offset by measurable public benefits.

4. The City's development impact fees can be "leveraged" through the use of fee credit and reimbursement agreements with developers and landowners.

5. The City's aggregate fee levels should not render new development that is otherwise consistent with City plans and regulations economically infeasible. Aggregate fee levels should be evaluated in terms of a reasonable standard, but not a strict limit (e.g., aggregate fee levels should not exceed an average of approximately 10 to 12 percent of the market value of the new development, either on a per-unit or per-square foot basis).

6. The City may consider reductions or waivers of its development impact fees in cases where a development project meets specific City planning or economic development policies such as affordable housing projects. In such cases the amount of funding foregone must be replaced with other funding sources available to the City.

1. ***Special Tax District Administration.*** In the case of Mello-Roos or similar special tax districts, the total maximum annual tax should not exceed 110% of annual debt service. The rate and method of apportionment should include a back-up tax in the event of significant changes from the initial development plan and should include procedures for prepayments.

   a. Community Facilities Districts or Assessment Districts offer a way to fund infrastructure, maintenance, or municipal services through special taxes or assessments levied on property owners benefiting from the thus-funded improvements or services. It can be used for both capital improvements and ongoing facility maintenance or services.

   b. The City will consider the formation of financing districts using the State's assessment law or the Mello-Roos Community Facilities Act for its newly developing areas on a case- by-case basis, consistent with technical analysis and City priorities (i.e., capital or ongoing funding).

   c. The City will consider the effect of the special tax on the City's ability to issue General Obligation bonds or other property-based tax measures.

   d. Such districts should fund infrastructure or services serving or otherwise providing benefit to the area subject to the assessment or special tax.

   e. Such districts can fund public facilities or infrastructure otherwise funded with the City's development impact fees or project-specific exactions. In such cases the area's development impact fee obligations will be adjusted proportionately.

   f. Within any such districts, property value-to-lien ratio should, consistent with typical underwriting standards, be at least 4.0:1 after calculating the value of the financed public improvements to be installed and considering any prior or pending special taxes or improvement liens.

   g. Consistent with underwriting standards and market considerations, and as a matter of policy, the City will limit the maximum amount of special taxes to be levied on any parcel of property within a Community Facilities District, in any given fiscal year, together with the general property taxes, general obligation bonds, and other special taxes and assessments levied on such parcel, shall not exceed an amount equal to one and eight- tenths percent (1.8 percent) of the projected assessed value of the parcel (and improvements if applicable). How the special tax capacity is allocated between capital and ongoing expenditures will depend upon the City's priorities.

   h. The City shall have discretion to allow a special tax in excess of the established limits for any lands within the CFD which are designated for commercial or industrial uses.

   i. As a part of such district formations, the City will retain a special tax consultant to prepare a report which recommends a special tax rate and method for the proposed CFD and evaluates the special tax proposed to determine its ability to adequately fund identified public facilities, City administrative costs, services (if applicable) and other related expenditures.

2. ***Foreclosure Covenants.*** In managing administrative costs, the City will establish minimum delinquency amounts per owner, and for the district as a whole, on a case-by-case basis before initiating foreclosure proceedings.

3. ***Disclosure to Bondholders.*** In general, each property owner who accounts for more than 10% of the annual debt service or bonded indebtedness must provide ongoing disclosure information annually as described under SEC Rule 15(c)-12.

4. ***Disclosure to Prospective Purchasers.*** Full disclosure about outstanding balances and annual payments should be made by the seller to prospective buyers at the time that the buyer bids on the property. It should not be deferred to after the buyer has made the decision to purchase. When appropriate, applicants or property owners may be required to provide the City with a disclosure plan.

Conduit Financings

1. The City will consider requests for conduit financing on a case-by-case basis using the following criteria:

   a. The City's bond counsel will review the terms of the financing and render an opinion that there will be no liability to the City in issuing the bonds on behalf of the applicant.
   b. There is a clearly articulated public purpose in providing the conduit financing.
   c. The applicant is capable of achieving and maintaining this public purpose.

2. This means that the review of requests for conduit financing will generally be a two-step process:

   a. First asking the Council if they are interested in considering the request and establishing the ground rules for evaluating it.
   b. And then returning with the results of this evaluation and recommending approval of appropriate financing documents if warranted.

This two-step approach ensures that the issues are clear for both the City and applicant, and that key policy questions are answered.

3. The work scope necessary to address these issues will vary from request to request and will have to be determined on a case-by-case basis. Additionally, the City should generally be fully reimbursed for our costs in evaluating the request; however, this should also be determined on a case-by-case basis.

Refinancing

1. ***General Guidelines.*** Periodic reviews of all outstanding debt will be undertaken to determine refinancing opportunities. Refinancing will be considered (within federal tax law constraints) under the following conditions:

   a. There is a net economic benefit.
   b. It is needed to modernize covenants that are adversely affecting the City's financial position or operations.
   c. The City wants to reduce the principal outstanding in order to achieve future debt service savings, and it has available working capital to do so from other sources.

2. ***Standards for Economic Savings.*** In general, refinancing for economic savings will be undertaken whenever net present value savings of at least five percent (5%) of the refunded debt can be achieved.

   a. Refinancing that produce net present value savings of less than five percent will be considered on a case-by-case basis, provided that the present value savings are at least three percent (3%) of the refunded debt.
   b. Refinancing with savings of less than three percent (3%), or with negative savings, will not be considered unless there is a compelling public policy objective.

Enhanced Infrastructure Financing District Guidelines and Policies

a. EIFD financing should be considered for public facilities or infrastructure improvements that confer citywide and/or regional benefits. This may include the "City share" of infrastructure included in the City's development impact fees.

b. Unless there is a Development Agreement in place that provides otherwise, EIFDs should not be used to fund real estate projects' proportional share of infrastructure costs otherwise included in the City's development impact fees or charged as project-specific exactions (e.g., subdivision improvements).

c. City should consider EIFDs when more than one local government jurisdiction is participating to produce maximum benefit.

d. At the time of formation of the EIFD (or if changes to the EIFD are contemplated), the City should require a fiscal impact analysis to determine if an EIFD is fiscally prudent and analyze opportunity cost to the City's General Fund.

Glossary of Terms

Designated Bonds: bonds that have been labeled or "designated" to attract investors looking for investments that produce social or environmental benefits (examples include green bonds, sustainable bonds, social bonds, or other alternatively designated bonds).

Green Bonds: New and existing projects with environmental benefits (examples include terrestrial and aquatic biodiversity, clean transportation, renewable energy infrastructure, green buildings, water/wastewater management projects, natural resource conservation).

Social Bonds: New and existing projects with positive social outcomes (examples include affordable housing, food security and sustainable food systems, and access to essential services).

Sustainability Bonds: New and existing projects with both environmental and social benefits (examples include renewable energy, climate change adaptation or mitigation, and clean transportation).