Metropolitan Government of Nashville and Davidson County	**Subject:** Debt Management Practices	**Revision Date:** Dec 2011
Finance Dept Policy **Effective Date: December 6 2011**	**Sponsor:** Metropolitan Treasurer	

Purpose

The purpose of this policy is to establish and document the objectives and practices for debt management for the Metropolitan Government and to assist all concerned parties in understanding the Metropolitan Government's approach to debt management.

Definitions

Arbitrage - The difference between the interest paid on the tax-exempt securities and the interest earned by investing the security proceeds in higher-yielding taxable securities. IRS regulations govern arbitrage on the proceeds from issuance of municipal securities.

Balloon Maturity - A later maturity within an issue of bonds which contains a disproportionately large percentage of the principal amount of the original issue.

Back Loading - Delaying repayment of principal until late in the financing term.

Bond Anticipation Notes (BANs) - Notes which are paid from the proceeds of the issuance of long-term bonds. Typically issued for capital projects.

Bullet Maturity - A maturity for which there are no principal and/or sinking fund payments prior to the stated maturity date.

Call Provisions - The terms of the bond giving the issuer the right to redeem all or a portion of a bond prior to its stated date of maturity at a specific price, usually at or above par.

Capitalized Interest - A portion of the proceeds of a bond issue which is set aside to pay interest on the same bond issue for a specific period of time. Interest is commonly capitalized for the construction period of the project.

Commercial Paper - Short-term Bond Anticipation Note issued to pay capital project expenses, secured either by a Letter of Credit or by Metro's own General Obligation Pledge.

Competitive Sale - A sale/auction of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities. Contrast to a negotiated sale.

Conflicts of Interest – Situations where parties in a transaction have multiple interests or relationships that could possibly corrupt the motivation to act. The existence of a conflict of interest does not automatically indicate wrong doing.

Continuing Disclosure - The principle that accurate and complete information material to the transaction which potential investors would be likely to consider material in making investment decisions with respect to the securities be made available on an ongoing basis.

Costs – Fees and expenses of professionals and service providers and other similar fees and expenses at the time debt is incurred. Costs also means recurring and nonrecurring fees and expenses during the life of the debt.

Credit Enhancement - Credit support purchased by the issuer to raise the credit rating of the issue. The most common credit enhancements consist of bond insurance, direct or standby letters of credit, and lines of credit.

Debt service – Payments including interest and principal required on a debt over time.

Debt Service Coverage -Net Revenue available for debt service divided by debt service.

Debt Service Reserve Fund - The fund in which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements.

Deep Discount Bonds - Bonds which are priced for sale at a substantial discount from their face or par value.

Derivatives - A financial product whose value is derived from some underlying asset value.

Designation Policies - Outline how an investor's order is filled when a maturity is oversubscribed when there is an underwriting syndicate. The Financial Advisor, senior managing underwriter and issuer decide how the bonds will be allocated among the syndicate. There are three primary classifications of orders which form the designation policy: Group Net orders; Net Designated orders and Member orders.

Escrow - A fund established to hold moneys pledged and to be used to pay debt service on an outstanding issue.

Expenses - Compensates senior managers for out-of-pocket expenses including: underwriters counsel, DTC charges, travel, syndicate expenses, dealer fees, overtime expenses, communication expenses, computer time and postage.

Letters of Credit - A bank credit facility wherein the bank agrees to lend a specified amount of funds for a limited term.

Management Fee - The fixed percentage of the gross spread which is paid to the managing underwriter for the structuring phase of a transaction.

Members - Underwriters in a syndicate other than the senior underwriter.

Moody's Median - Key financial, debt, economic and tax base statistics with median values for each statistic presented.

Negotiated Sale - A method of sale in which the issuer chooses an underwriter or a team of underwriters led by a Managing Senior Underwriter to negotiate terms pursuant to which such underwriter/underwriters will purchase and market the bonds.

Net Revenue - Defined in greater detail by the Metropolitan Government's Indenture. Net Revenue is the difference between gross revenue and operating and maintenance expenses.

Original Issue Discount - The amount by which the original par amount of an issue exceeds its public offering price at the time it is originally offered to an investor.

Pay-As-You-Go - An issuer elects to finance a project with existing cash flow as opposed to issuing debt obligations.

Paying Agent – A firm that transfers periodic interest and principal payments from the Metro to investors. Often the same firm as Registrar.

Present Value - The current value of a future cash flow.

Private Placement - The original placement of an issue with one or more investors as opposed to being publicly offered or sold.

Rebate - A requirement imposed by Tax Reform Act of 1986 whereby the issuer of tax-exempt bonds must pay the IRS an amount equal to its profit earned from investment of tax-exempt bond proceeds at rates exceeding the tax-exempt borrowing rate. The tax-exempt borrowing rate (or "bond yield") is calculated pursuant to the IRS code together with all income earned on the accumulated profit pending payment.

Registrar – A firm responsible for maintaining a record or list of owners or investors in debt. Often the same firm as the Paying Agent.

Remarketing Agent – A firm responsible for reselling debt instruments that have been tendered by their holders. Also responsible for resetting the interest rate for variable rate debt.

Selling Groups - The group of securities dealers who participate in an offering not as underwriters but rather who receive securities less the selling concession from the managing underwriter for distribution at the public offering price.

Syndicate Policies - The contractual obligations placed on the underwriting group relating to distribution, price limitations and market transactions.

Underwriter - A dealer that purchases new issues of municipal securities from the Issuer and resells them to investors.

Underwriter's Discount - The difference between the price at which bonds are bought by the Underwriter from the Issuer and the price at which they are reoffered to investors.

Variable Rate Debt - An interest rate on a security which changes at intervals according to an index or a formula or other standard of measurement as stated in the bond contract.

Verification Agent – An independent third party that determines the cash flow from investments purchased with proceeds of a refunding debt issues will be sufficient to pay the refunded bonds.

General Policies

Policy Statement

The Policy is intended to guide current and future decisions related to debt issued by the Metropolitan Government. The Metropolitan Government has the right to waive any of the policies included herein. Any such waiver shall be in writing stating the reason for the waiver.

The Policy has also been guided by the policies and practices reflected in the Metropolitan Government's financial planning, management, budget, and disclosure documents.

Since the guidelines contained in the Policy require regular updating in order to maintain relevance and to respond to the changes inherent in the capital markets, the Metropolitan Government will modify this Policy from time to time. Any such modification shall be in writing and shall be formally adopted by the Director of Finance.

In managing its debt, it is the Metropolitan Government's policy to:

- Achieve the lowest cost of capital
- Ensure high credit quality
- Assure access to the capital credit markets
- Preserve financial flexibility
- Manage interest rate risk exposure

Goals & Objectives

Debt policies and procedures are tools that ensure that financial resources are adequate to meet the Metropolitan Government's financing objectives. In addition, the Policy helps to ensure that financings undertaken by the Metropolitan Government satisfy certain clear objective standards which allow the Metropolitan Government to protect its financial resources in order to meet its short-term financing and longterm capital needs. The adoption of clear and comprehensive financial policies enhances the internal financial management of the Metropolitan Government.

The Policy formally establishes parameters for issuing debt and managing a debt portfolio to meet the Metropolitan Government's specific financing needs; assure the ability to repay financial obligations; and provide for consideration of existing legal, economic, and financial and debt market conditions. Specifically, the policies outlined in this document are intended to assist in the following:

- To guide the Metropolitan Government and its managers in policy and debt issuance decisions;
- To maintain appropriate capital assets for present and future needs;
- To promote sound financial management;
- To protect and enhance the Metropolitan Government's credit rating;
- To ensure the legal use of funds obtained through the Metropolitan Government's debt issuance;
- To promote cooperation and coordination with other stakeholders in the financing and delivery of services;
- To avoid conflicts of interest and promote full disclosure of aspects of the transaction and
- To ensure evaluation of debt issuance options.

Issuance Process

All debt issuance will conform to requirements of the Charter of the Metropolitan Government and Title 9, Chapter 21 of the Tennessee Code Annotated. Other sections of the Tennessee Code Annotated and the Federal Tax Code may govern issuance or structure of the Metropolitan Government's bonds. Each bond issuance resolution of the Metropolitan Council will contain information, in the form of a Preliminary Official Statement, to ensure transparency of cost and use of professionals for the bond issue. The Preliminary Official Statement and the resulting Official Statement will be published on the Finance Department's Investor Relations section of the Metro Web site.

The Metropolitan Government prefers a competitive issuance process for debt issuances. The Metropolitan Government will consider negotiated issuance or private placement where it is clear that such process is in the best interests of the Metropolitan Government. A brief description of preferences for each sale process is listed below:

1. **Competitive Sale.** Bonds are awarded to the bidder providing the lowest true interest cost as long as the bid adheres to the requirements set forth in the official notice of sale. 2. **Negotiated Sale.** The Metropolitan Government will consider negotiated sales if they are in its best interest.

3. **Private Placement.** The Metropolitan Government may elect to privately place its debt. Such placement shall be considered if it is demonstrated to result in a cost savings relative to other methods of debt issuance.

Without regard to the type of sale the Metropolitan Government will comply with all required disclosures including information on cost of the transaction.

These provisions serve as a basis for the Metropolitan Government's affordability guidelines described later in this policy.

Credit Quality and Credit Enhancement

The Metropolitan Government's debt management activities will be conducted to receive the highest credit ratings possible, consistent with the Metropolitan Government's financing objectives. The Director of Finance will be responsible for maintaining relationships and communicating with the rating agencies that assign ratings to the Metropolitan Government's debt. The Director of Finance will provide the rating agencies with periodic updates of the general financial condition of the Metropolitan Government. Full disclosure of operations and open lines of communication shall be maintained with the rating agencies. The Metropolitan Government, together with the Financial Advisor, shall prepare presentations to the rating agencies to assist credit analysts in making an informed decision. 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 will be asked to provide such rating.

The Metropolitan Government will consider the use of credit enhancements on a case-by-case basis, evaluating the economic benefit versus cost for each case. Only when clearly demonstrable savings can be shown shall an enhancement be considered. The Metropolitan Government will consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancements: Metropolitan Government of Nashville Davidson Co.

Bond Insurance - The Metropolitan Government may purchase bond insurance when such purchase is deemed prudent and advantageous for negotiated sales. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds. For competitive sales, the purchaser of the bonds will determine whether bond insurance will be used.

The Metropolitan Government will solicit quotes for bond insurance from interested providers, or in the case of a competitive sale, allow bidders to request bond insurance. In a negotiated sale, the Metropolitan Government will competitively select a provider who is most cost effective and whose terms and conditions governing the guarantee are satisfactory to the Metropolitan Government. The winning bidder in a competitive sale will determine the provider of bond insurance.

Letters of Credit - The Metropolitan Government may enter into a letter-of-credit (LOC) or standby bond purchase agreement when such an agreement is deemed prudent and advantageous. The Metropolitan Government will prepare and distribute a request for qualifications to qualified banks which includes terms and conditions that are acceptable to the Metropolitan Government.

Debt Affordability -It is the intent of the Metropolitan Government to promote the most efficient and cost-effective use of debt financing in order to facilitate long-term access to capital while ensuring that financial leveraging decisions do not negatively impact the Metropolitan Government's annual operations. To this end, the government will periodically review basic measures of debt affordability, including but not limited to, average life of new debt, percentage of principal paid within 10 years, per capita debt/per capita income, per capita debt/per capita assessed value, and debt service/general fund operating expenses.

Bond Structure -The Metropolitan Government shall establish all terms and conditions relating to the issuance of bonds, and will invest all bond proceeds pursuant to the terms of the Metropolitan Government's Investment Policy.

Unless otherwise authorized by the Metropolitan Government, the following shall serve as bond requirements:

1. **Term.** Capital improvements financed through the issuance of debt will be financed for a period not to exceed the useful life of the improvements with a maximum of twenty (20) years. In certain circumstances where the debt meets legal requirements and is in the best interest of the Metropolitan Government this period may be extended to a maximum of thirty (30) years.

2. **Capitalized Interest**. From time to time certain financings may require the use of capitalized interest from the issuance date until the Metropolitan Government has beneficial use and/or occupancy of the financed project. Interest shall not be funded (capitalized) beyond three (3) years or a shorter period if further restricted by statute. Interest earnings may, at the Metropolitan Government's discretion, be applied to extend the term of capitalized interest but in no event beyond the term statutorily authorized or three years, whichever is shorter.

3. **Debt Service Structure**. Debt issuance shall be planned to achieve relatively level debt service for an individual bond issue, while still matching debt service to the useful life of the capital asset financed by the debt. The Metropolitan Government shall avoid the use of bullet or balloon maturities except in those instances where these maturities serve to make existing overall debt service level or match a specific income stream.

4. **Call Provisions.** In general, the Metropolitan Government's securities will include a call feature, which is no later than ten (10) years from the date of delivery of the bonds. The Metropolitan Government will avoid the sale of long-term non-callable bonds absent careful evaluation by the Metropolitan Government with respect to the value of the call option.

5. **Original Issuance Discount/Premium.** - Bonds with original issuance discount/premium will be permitted.

6. **Deep Discount Bonds** - Deep discount bonds may provide a lower cost of borrowing in certain markets. The Metropolitan Government will carefully consider their value and effect on any future refinancing as a result of the lower-than-market coupon.

7. **Synthetic Debt** - The Metropolitan Government will consider the limited use of swaps, derivatives and other forms of synthetic debt as a hedge against future interest rate risk when appropriate and in accordance with state guidelines. The Metropolitan Government will not use structured products for speculative purposes. The Metropolitan Government will consider the use of structured products when it is able to gain a comparative borrowing advantage and is able to quantify and understand the potential risks or to achieve fixed and/or variable rate exposure targets.

Types of Debt

When the Metropolitan Government determines that the use of debt is appropriate, the following criteria will be utilized to evaluate the type of debt to be issued.

Structure

1. **General Obligation Bonds** - The Metropolitan Government may issue general obligation bonds supported by the full faith and credit of the Metropolitan Government. General obligation bonds shall be used to finance capital projects that do not have independent creditworthiness and significant ongoing revenue streams. The Metropolitan Government may also use its general obligation pledge to support other bond issues, if such support improves the economics of the other bond issue and is used in accordance with these guidelines.

2. **Revenue Bonds** - The Metropolitan Government may issue revenue bonds, where repayment of the bonds will be made through revenues generated from other sources. Revenue bonds will typically be issued for capital projects which can be supported from project or enterprise-related revenues.

Duration

1. **Long-Term** Debt - The Metropolitan Government may issue long-term debt where it is deemed that capital improvements should not be financed from current revenues or short-term borrowings. Long-term borrowing will not be used to finance current operations or normal maintenance. Long-term debt will be structured such that financial obligations do not exceed the expected useful life of the project.

a) Serial and Term Bonds may be issued in either fixed or variable rate modes to finance capital infrastructure projects with an expected life of five years or greater.

b) Capital Outlay Notes may be issued to finance capital infrastructure projects with an expected life of three to twelve years.

2. **Short-Term Debt** - Short-term borrowing may be utilized for construction financing, the temporary funding of operational cash flow deficits or anticipated revenues (defined as an assured source with the anticipated amount based on conservative estimates) subject to the following policies:

a) Bond Anticipation Notes (BANs) in the form of Commercial Paper shall be used only for the purpose of providing financing for the cost of all or any of the public purposes for which Bonds have been authorized and for the payment of principal of outstanding commercial paper.

b) Revenue Anticipation Notes (RANs)and Tax Anticipation Notes (TANs) shall be issued only to meet cash flow needs consistent with a finding by bond counsel that the sizing of the issue fully conforms to Federal IRS and state requirements and limitations.

c) Lines of Credit shall be considered as an alternative to other short-term borrowing options. The lines of credit shall be structured to limit concerns as to the Internal Revenue Code.

d) Other Short-Term Debt may be used when it provides an interest rate advantage or as interim financing until market conditions are more favorable. The Metropolitan Government will determine and utilize the least costly method for short-term borrowing. The Metropolitan Government may issue short-term debt when there is a defined repayment source or amortization of principal.

Interest

1. **Fixed Rate Debt** - To maintain a predictable debt service burden, the Metropolitan Government will generally give preference to debt that carries a fixed interest rate.

2. **Variable Rate Debt** - The Metropolitan Government, however, may consider variable rate debt if it is in the best interest of the government. The percentage of net variable rate debt outstanding (excluding debt which has been converted to synthetic fixed rate debt and debt matched to assets) shall not exceed 30% of the Metropolitan Government's total outstanding debt.

Synthetic Debt

The Director of Finance will determine whether the use of synthetic debt, such as interest rate swaps or options, is appropriate and will comply with the state statutes regulating the use of synthetic debt.

Swaps may be considered to lock-in a current market fixed rate, produce interest rate savings, alter the pattern of debt service payments, asset/liability matching purposes, or to cap, limit or hedge variable rate payments.

Options granting the right to commence or cancel an underlying swap may be considered to the extent the swap itself is in the best interest of the Metropolitan Government.

Synthetic debt, like all other debt, is subject to the approval of the Metropolitan Council and Mayor.

Guidelines for the Use of Swaps and Options

In connection with the use of any swaps, the Director of Finance shall make a finding that the authorized swaps contemplated herein are designed to reduce the amount or duration of the interest rate risk or result in a lower cost of borrowing when used in combination with the issuance of the Bonds or enhance the relationship between the risk and return with respect to the Metropolitan Government's investments or program of investment.

1. Rationale for Using Swaps and Options. The use of derivative financial products should provide a higher level of savings benefit relative to a non-synthetic structure to the Metropolitan Government, or otherwise help the Metropolitan Government to meet the objectives outlined herein, as the Metropolitan Government may determine in its sole discretion.

2. Limitations. The Metropolitan Government may not use financial instruments that in the Metropolitan Government's sole discretion:

- Are speculative or create extraordinary leverage or risk
- Lack adequate liquidity to terminate at market
- Provide insufficient price transparency to allow reasonable valuation

3. Understanding the Risks. The Metropolitan Government will consider all risk factors in determining whether to enter into a swap or other derivative transaction, including, but not limited to:

- Market or Interest Rate Risk
- Tax Risk
- Liquidity Risk
- Termination Risk
- Risk of Uncommitted Funding (Put Risk)
- Legal Risk
- Counterparty Risk
- Rating Agency Risk
- Basis Risk
- Tax Exemption Risk
- Accounting Risk
- Administrative Risk
- Amortization Risk
- Subsequent Business Conditions

4. **Qualified Swap Counterparties.** The Metropolitan Government shall be authorized to enter into interest rate swap transactions only with qualified swap counterparties. The Director of Finance, in consultation with the Metropolitan Council and the Metropolitan Government's Financial Advisor, shall identify the qualified swap counterparties for each transaction.

5. **Reporting.** A report providing the status of all interest rate swap agreements entered into by the Metropolitan Government will be provided in accordance with the State Funding Board's Guidelines for Interest Rate and Forward Purchase Agreements.

Refinancing Outstanding Debt

The Director of Finance for the Metropolitan Government, with assistance from the Metropolitan Government's Financial Advisor, shall have the responsibility to analyze outstanding bond issues for refunding opportunities.

The Metropolitan Government will consider the following issues when analyzing possible refunding opportunities:

1. **Debt Service Savings** - The Metropolitan Government establishes a minimum present value savings threshold of 3.5% of the refunded bond principal amount. The present value savings will be net of all costs related to the refinancing. If present value savings is less than 3.5%, the Metropolitan Government may consider the option value captured as a percent of total savings. If the option value exceeds 70% and present value savings is less than 3.5%, the Metropolitan Government may opt to complete a refunding. The decision to take savings on an upfront or deferred basis must be explicitly approved by the Metropolitan Government.

2. **Restructuring** - The Metropolitan Government will refund debt when it is in the best financial interest of the Metropolitan Government to do so. Such refunding will be limited to restructuring to meet unanticipated revenue expectations, achieve cost savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants.

3. **Term of Refunding Issues** - The Metropolitan Government will refund bonds within the term of the originally issued debt. However, the Metropolitan Government may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible. The Metropolitan Government may also consider shortening the term of the originally issued debt to realize greater savings. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.

4. **Escrow Structuring** - The Metropolitan Government shall utilize the least costly securities available in structuring refunding escrows. A certificate will be provided by a third party agent, who is not a broker-dealer stating that the securities were procured through an arms-length, competitive bid process (in the case of open market securities), that such securities were more cost effective than State and Local Government Obligations (SLGS), and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the Metropolitan Government from its own account.

5. **Arbitrage** - The Metropolitan Government shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refunding.

Professionals/Consultants

The Metropolitan government will use various professionals/consultants as necessary depending upon the type of debt transaction anticipated. These professionals/consultants include:

- **Bond Counsel** - Metropolitan Government debt will include a written opinion by legal counsel affirming that the Metropolitan Government is authorized to issue the proposed debt, that the Metropolitan Government has met all legal requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. The approving opinion and other documents relating to the issuance of debt will be prepared by counsel with extensive experience in public finance and tax issues. The counsel will be selected by the Metropolitan Government.
- **Counterparty**
- **Financial Advisor** - The Metropolitan Government shall select a financial advisor (or advisors) to assist in its debt issuance and debt administration processes. The financial advisor will assist the Metropolitan Government with the structuring, analysis, planning and execution of debt transactions. The financial advisor will not act as underwriter and/or be permitted to bid on issues. The financial advisor will also assist the Metropolitan Government in assessing debt capacity and other long term debt planning.
- **Paying Agent**
- Registrar
- Remarketing Agent
- Swap Advisor
- Swap Counsel
- Trustee
- Underwriter
- Verification Agent

Conflict of Interest - The Metropolitan Government requires that its consultants and advisors provide objective advice and analysis and be free from any conflicts of interest.

Disclosure by. professionals/consultants - All professionals/consultants will be required to provide full and complete disclosure, relative to agreements with other professionals/consultants, financing team members and outside parties. The extent of disclosure may vary depending on the nature of the transaction and will always include disclosure of all compensation (including "soft costs") and considerations received related to the transaction. However, in general terms, no agreements shall be permitted which could compromise the firm's ability to provide independent advice which Metropolitan Government of Nashville Davidson County is solely in the Metropolitan Government's best interests or which could reasonably be perceived as a conflict of interest. Consultants will provide an annual affirmative statement that no such conflicts of interest exist.

Disclosure

The Metropolitan Government will provide annual financial and economic information to all Nationally Recognized Municipal Information Repositories (NRMSIRs) designated by the SEC and the State Information Depository (SID).

The Metropolitan Government will also maintain a system of record keeping and reporting which complies with the arbitrage rebate compliance requirements of the federal tax code.

Applicable Local, State or Federal Regulations Charter of the Metropolitan Government of Nashville and Davidson County – Article 7 Bond Issue Tennessee Code Annotated – Title 9 Chapter 21 Local Government Public Obligations Law Internal Revenue Code - TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART IV, Subpart B, Sec. 148 Arbitrage

Effective Date

This Policy Statement - shall become effective upon issuance and shall be applied to all Metro departments and agencies.

Richard M. Riebeling
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