FCMAT
FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
CSIS California School Information Services

Fiscal Alert

January 2017

Increased Requirements for Debt Management Policy and Practices

Background

Some local educational agencies (LEAs) have adopted debt management policies to provide guidelines for issuing general obligation bonds, certificates of participation (COPs) and other forms of indebtedness. FCMAT has provided a sample debt management policy for several years.

Government Code 8855(i) requires any issuer of public debt to provide a *Report of Proposed Debt Issuance* to the California Debt Investment and Advisory Commission no later than 30 days before the sale of such debt.

New Requirements

Effective January 1, 2017 (per Senate Bill 1029 approved September 12, 2016), the *Report of Proposed Debt Issuance* requires certification that the issuer has adopted a local policy regarding the use of debt and that the proposed debt issuance is consistent with the policy. The local debt policy must include the following five items:

1. The purposes for which the debt proceeds may be used.
2. The types of debt that may be issued.
3. The debt's relationship to and integration with the issuer's capital improvement program or budget, if applicable.
4. Policy goals related to the issuer's planning goals and objectives.
5. The internal control procedures that the issuer has implemented or will implement to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

In addition, Senate Bill (SB) 1029 states:

> The Legislature hereby finds and declares all of the following:
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> . . .
>
> State and local agencies should adopt comprehensive written debt management policies pursuant to the recommendation of the Government Finance Officers Association, a professional organization of over 18,000 public officials united to enhance

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> and promote the professional management of governmental financial resources. These policies should reflect local, state, and federal laws and regulations.

FCMAT has updated its *Sample Debt Management Policy* to conform to the requirements of both SB 1029 and the Government Finance Officers Association's published best practice on debt management policy (see http://www.gfoa.org/debt-management-policy).

Local educational agencies may want to review existing policies in the 3000, 7000 and 9000 series for existing references to debt or bonds that might be removed in light of adoption of a single comprehensive policy.

Additional Assistance

For additional assistance, LEAs should contact their respective oversight agencies. LEAs may also visit FCMAT's website at www.fcmat.org and submit an online request for assistance.

Sample Debt Management Policy

BP 3461 Business and Noninstructional Operations

Debt Management Policy

Purpose

The district recognizes that the foundation of a well-managed debt program is a comprehensive debt policy that guides the issuance of debt, management of the debt portfolio, and adherence to relevant laws and regulations.

The purpose of this policy is to improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning.

This debt policy sets forth comprehensive guidelines for financing capital expenditures, as well as for addressing short-term cash flow needs. The objectives of this policy are that:

1. The district obtain financing only when necessary.
2. The district use any type of debt financing allowed by California law (e.g., general obligation bonds, revenue bonds, special tax bonds, certificates of participation, lease-purchase financings, tax and revenue anticipation notes, temporary transfers from the county treasury or county superintendent of schools, bond anticipation notes), so long as the financing meets the standards for appropriateness and efficiency described below.
3. The district use a process for identifying the most appropriate and efficient timing, amount and structure of debt.

   Factors to consider when determining the appropriateness of debt are to include the following:

   - Why debt rather than cash expenditure is appropriate.
   - Annual debt service and debt administration costs.
   - The district's financial condition.
   - The district's tax base.
   - Repayment source, including the amount available and its reliability.
   - Legal constraints resulting from the debt (e.g., prepayment terms, reporting requirements).
   - Additional future capital needs.
   - Type of debt instrument.

   Factors to consider when determining efficiency are to include the following:

   - Up-front cost plus long-term costs.
   - Future flexibility.
4. The district operate with extreme caution, and thoroughly investigate all possible conflicts of interest.
5. The district ensure that any required initial and periodic reporting to investors, credit rating agencies, trustees, federal and state agencies, and the county superintendent of schools is timely and accurate.

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The governing board will review this policy at least annually and update it as needed. Such a review will include a review of the then-current Government Finance Officers Association's (GFOA's) best practices on debt management policy.

Short-Term Operating Debt Policy

The expenditures associated with the district's day-to-day operations will be covered by current revenues. However, the district may experience temporary cash shortages because it does not receive its revenues in equal installments each month, yet the largest operating expenditures occur regularly in equal amounts. To finance these temporary cash shortfalls, the district may incur short-term operating debt, typically in the form of temporary transfers from the county treasury or county superintendent of schools, or tax and revenue anticipation notes (TRANS). The district will base the amount of the short-term operating debt on cash flow projections for the fiscal year and will comply with applicable federal and state regulations. The district will pledge operating revenues to repay the short-term debt in one year or less. The district will minimize the cost of the short-term borrowing to the greatest extent possible. As allowed by Education Code Section 42603, the district should first consider using interfund transfers before pursuing external borrowing.

Long-Term Capital Debt Policy

The following will apply to the issuance of long-term debt:

1. The district will not use long-term obligations for operating purposes.
2. The term of the long-term obligations will not exceed the useful life of the projects financed.
3. The district will strive to minimize increases in debt service from year to year.
4. When any long-term debt is issued, the governing board will make findings as to the repayment source(s) and the sufficiency of the repayment source(s) until the debt is fully repaid.

Internal Interim Financing

When sufficient funds are available, per Education Code section 42603,the district will consider appropriating them to provide interim financing until long-term financing can be completed, usually within the fiscal year. When the long-term debt obligation is subsequently issued, the funds will be repaid. Use of this strategy requires specific advance notification to the governing board.

Responsibilities of the Chief Business Official

The chief business official will have the primary responsibility for developing financing recommendations and ensuring implementation of the debt policy.

1. The chief business official will review the operating cash flow monthly to determine the need for internal borrowing to maintain progress on the capital improvement program.
2. The chief business official will review the district's capital improvement program at least annually, including the need for financing to maintain the progress on the capital improvement program. This review will be presented to the school board annually. Best practice is to do so in documented form either as part of the adopted budget or in the district's *Management, Discussion and Analysis* prepared for the annual audit report.
3. Because issuing debt is a periodic endeavor and the capital markets constantly change, at least 30 days prior to consideration of any financing the chief business official will review all current GFOA best practices, advisories and guidance documents (found at GFOA.org) and identify to the governing board those relevant to the current capital improvement program and/or operating cash flow needs. This will be done before any governing board action item on the topic of financing.

4. The chief business official will supervise all details of financing endeavors, including a careful review of the documents (e.g., contracts, resolutions, agreements, financial tables).
5. The chief business official will administer the investment of debt proceeds, with the advice of the county treasurer.
6. The chief business official will oversee the expenditure of the debt proceeds and ensure that the debt payments are made on time.
7. The chief business official will ensure that any initial and periodic reporting needed — such as to investors, credit rating agencies, trustees, federal (e.g., the Internal Revenue Service, the Securities and Exchange Commission) and state agencies (e.g., the California Debt and Investment Advisory Commission), and the county superintendent of schools — is timely and accurate.
8. Before any financing is submitted to the governing board for approval, the chief business official will take into consideration the district's internal control procedures, and consult with the district's external auditor regarding fiscal controls needed to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

Engagement of Professionals

This policy recognizes that public finance professionals (e.g., financial advisors, bond counsels, brokers/dealers, and other consultants) market their services extensively. Furthermore, per Public Contract Codes 20110–20118.4, such services are usually exempt from public bidding. To ensure that the district receives appropriate services at a fair price, and to avoid the appearance of conflict of interest, extra caution will be taken when engaging the services of public finance professionals.

Before seeking or considering contracts with public finance professionals, the chief business official will review the then-current GFOA best practices on the following topics:

- Selecting and Managing Municipal Advisors
- Selecting and Managing the Method of Sale of Municipal Bonds
- Selecting Bond Counsel
- Selecting and Managing Underwriters for Negotiated Bond Sales
- Issuer's Role in Selection of Bond Counsel

The chief business official (and the district's purchasing agent) will report to the governing board on a recommended process for determining which professionals are needed, how they will be identified (e.g., request for proposal, or bid), and how their contracts will be developed before being submitted to the governing board for approval. Emphasis will be placed on competition, openness, clarity, and avoiding conflicts of interest. The process recommended may be for a period of time, or for a particular financing or set of financings.

All engagement letters, contracts, disclosures and opinions will be provided to the governing board promptly, and district staff will not sign any such documents without prior notification to the governing board.

References

California Codes:

Education Codes 15140–15150 — Issuance and Sale of Bonds

Education Codes 41000–41003.3 — Moneys Received by School Districts

Education Codes 41010–41023 — Accounting Regulations, Budget Controls and Audits

Senate Bill 1029 — approved by the governor on September 12, 2016; amends Government Code 8855

Government Codes 16430–16495.5 — Investments

Government Codes 53600–53610 — Investment of Surplus

Probate Codes 16045–16054 — Uniform Prudent Investor Act

Public Contracts Code 20110–20118.4 — School Districts

Other:

GFOA best practice — Debt Management Policy, dated October 2012 (http://www.gfoa.org/debt-management-policy)

GFOA debt management documents and resources at http://www.gfoa.org/topic-areas/debt-management