



Presentation to Tennessee Government Finance Officers Association

Re: Debt Management Policies

March 25, 2011



Debt Management Policies

Recent concerns in Tennessee and across the Nation about debt transactions due to:

- **Not understanding the transaction**
- **Lack of transparency**
- **Self-dealing/ excessive costs**
- **“Kicking the can down the road”**
- **Too much debt**



Debt Management Policies

Four principles for strong financial management in the public sector:

- Understand the transaction
- Explain to citizens what is being considered
- Avoid conflicts of interest
- Disclose costs and risks



Debt Management Policies

**What is a debt
management policy?**



Debt Management Policies

- **How to finance debt**
- **How to structure and sell debt**
- **How to manage debt**
- **How to fit debt in overall financial management**



Debt Management Policies

**Why have a debt
management policy?**



Debt Management Policies

Adopting a debt management policy can help a public entity:

- Make better financial decisions;
- Provide clear objectives for staff;
- Demonstrate strong financial management practices to credit rating agencies; and
- Distinguish policy decisions from transaction decisions.



Debt Management Policies

T.C.A. Section 9-21-151(b)(1) authorizes the State Funding Board to develop model Finance Transaction Policies, including a debt management policy, for use by Public Entities.



Attachment C:

Glossary

Finance transaction means both debt obligations and derivatives.

A **derivative** is a financial product deriving value from a separate security.

This term refers to many different products.

“Derivative” includes an Interest Rate Agreement as defined in Tennessee Code Annotated Section 9-22-103 and other transactions as identified by the State Funding Board.



Members of Funding Board

- Bill Haslam, Governor, *Chairman*
- Justin P. Wilson, Comptroller of the Treasury, *Secretary*
- Tre Hargett, Secretary of State
- David H. Lillard, Jr., State Treasurer
- Mark A. Emkes, Commissioner of Finance & Administration



Debt Management Policies

Timeline:

November 2, 2009- Publicly began seeking input from interested persons

September 22, 2010- Public hearing held

December 15, 2010- SFB adopted statement on debt management



Debt Management Policies

**What debt management
policy should be
adopted?**



Debt Management Policies

A public entity needs to adopt its own policy designed for its own needs.

“local decision making and responsibility”



Debt Management Policies

■ **Definitions:**

- Public entity- state, state agency, local government, local government instrumentality, and any board, district, instrumentality, or entity created by them or any combination
- Debt obligation- bonds, notes, capital leases, loan agreements, or evidence of lawful indebtedness (agreements to repay money over time)



Debt Management Policies

Adoption of policy

- Is evidence of strong financial management practice
- Separates policy discussion from immediacy of transaction
- Provides guidance for decision-making
- Does NOT prevent unforeseen or negative events from occurring



Debt Management Policies

Adoption Process

When adopting the debt management policy in an *open transparent process*, the public entity needs to:

- Articulate
- Discuss
- Adopt



Debt Management Policies

Deadline

January 1, 2012 is the deadline for public entities to have their own debt management policies in place in order to issue or enter into debt.



Debt Management Policies

What must be in the debt management policy?



Debt Management Policies

A debt management policy must address (minimum requirements):

- Transparency
- Professionals (Written agreements, disclosures of compensation and fees, permitted roles)
- Conflicts of interest
- Specific justification of deferral of principal repayment (No blanket approval)



Attachment A: Minimum Language- Transparency

The Entity shall comply with legal requirements for notice and for public meetings related to debt issuance. In the interest of transparency, all costs (including interest, issuance, continuing, and one-time) shall be disclosed to the citizens/members, governing body, and other stakeholders in a timely manner. (*The method for disclosure of costs and other information, including documentation of compliance with the policy, shall be developed and outlined in the policy.*)



Minimum Language- Transparency

“Clear disclosure of terms and life of each debt issue, including principal and interest payments”
and “debt service schedule outlining the rate of retirement for the principal amount”



Attachment C: Glossary

Costs means fees and expenses of professionals and service providers and other similar fees and expenses, whether or not payable at the time the debt is incurred. “Costs” also means recurring and nonrecurring fees and expenses during the life of the debt.



Issues and Considerations

Professional selection

- Process
 - Timing
 - Criteria
 - Documentation/contracts
- Financial Advisor
 - Bond Counsel
 - Issuer's Counsel
 - Underwriter/Banker/Lender
 - Trustee/Paying Agent



Attachment A:

Minimum Language- Professionals

The Entity shall require all professionals engaged in the process of issuing debt to clearly disclose all compensation and consideration received related to services provided in the debt issuance process by both the Entity and the lender or conduit issuer, if any. This includes “soft” costs or compensations in lieu of direct payments.



Attachment A:

Minimum Language- Counsel

Counsel¹: The Entity shall enter into an engagement letter agreement with each lawyer or law firm representing the Entity in a debt transaction. *(No engagement letter is required for any lawyer who is an employee of the Entity or lawyer or law firm which is under a general appointment or contract to serve as counsel to the Entity. The Entity does not need an engagement letter with counsel not representing the Entity, such as underwriters' counsel.)*

¹ The requirement for an engagement letter does not apply to any lawyer who is an employee of the Entity or any lawyer or law firm under a general appointment as counsel to the Entity and not serving as bond counsel for the transaction. If bond counsel for a debt transaction does not represent the Entity in that transaction, the Entity will enter into a fee payment letter agreement with such lawyer or law firm specifying:

- a) the party represented in the debt transaction; and
- b) the Entity's obligation with respect to the payment of such lawyer or law firm's fees and expenses.



Attachment A:

Minimum Language- FA

Financial Advisor ⁱⁱ: *(If the Entity chooses to hire financial advisors, the Entity must select between the following options.) The Entity shall enter into a written agreement with each person or firm serving as financial advisor in debt management and transactions.*

- In a competitive sale, the financial advisor (*either*):
 - shall not be permitted to bid on an issue for which they are or have been providing advisory services; **or**
 - may bid on an issue for which they are providing advisory services only if (i) the governing body or designated official grants in writing specific authority on a transaction by transaction basis, (ii) such sale is properly carried out through a widely and publicly advertised sale, during normal bond sale hours, and through an industry standard, electronic bidding platform not requiring verification by the financial advisor, and (iii) the financial advisor fee is separately disclosed and billed from the underwriting fee financial advisor fee is separately disclosed and billed from the underwriting fee.

ⁱⁱ It is anticipated that the role of the financial advisor will be clarified by the Municipal Securities Rulemaking Board in the next few years. Policies will have to be adjusted to comply with any such clarification.



Attachment A: Minimum Language- FA continued

- In a publicly offered, negotiated sale, the financial advisor (*either*):
 - shall not be permitted to resign as financial advisor in order to underwrite an issue for which they are or have been providing advisory services; or
 - may resign as financial advisor in advance of negotiations in order to underwrite an issue for which they are or have been providing advisory services.



Attachment A: Minimum Language- Underwriter

Underwriter: *(If there is no financial advisor)*

The underwriter in a publicly offered, negotiated sale shall be required to provide pricing information both as to interest rates and to takedown per maturity to the governing body (or its designated official) in advance of the pricing of the debt.



Attachment C: Glossary

Conflicts of Interest occur in situations where parties in a transaction have multiple interests or relationships that could possibly corrupt the motivation to act. The presence of a conflict of interest indicates the potential for divided loyalty and does not automatically indicate wrong doing.



Attachment A:

Minimum Language- Conflicts

Professionals involved in a debt transaction hired or compensated by the Entity shall be required to disclose to the Entity existing client and business relationships between and among the professionals to a transaction (including but not limited to financial advisor, swap advisor, bond counsel, swap counsel, trustee, paying agent, underwriter, counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall include that information reasonably sufficient to allow the Entity to appreciate the significance of the relationships.



Attachment A:

Minimum Language- Conflicts cont.

Professionals who become involved in the debt transaction as a result of a bid submitted in a widely and publicly advertised competitive sale conducted using an industry standard, electronic bidding platform are not subject to this disclosure. No disclosure is required that would violate any rule or regulation of professional conduct.



Attachment C: Glossary

Backloading refers to delaying repayment of principal until the end of the financing term. A standard or default structure for debt service is level debt service payments, similar to a standard home mortgage. Backloading should be considered only when beneficial to the overall amortization of debt, upon the occurrence of natural disasters, or when project revenues are not available during the early years of a project.



Debt Management Policies

**What else should be in
the debt management
policy?**



Recommendations

It is strongly recommended that the public entity address:

- Maximum total level of debt
- Level and type of variable rate debt
- Process for decision-making and debt issuance
- Management and monitoring of issued debt
- Plan for regular review and update of policy



Recommendations

Guidance and restrictions for governing body

- Planning and decision-making
- Limitation on:
 - Debt outstanding
 - “as per capita debt”
 - “a comparison of debt to property values”
 - Annual debt service
 - “debt service as a percentage of revenues or expenditures”

“The policy should either require or recommend that this limitation be evaluated before additional debt is assumed and be monitored and reported to the governing body periodically .”



Recommendations

- Limitations on:
 - Debt structures
 - Maximum maturity:
 - “In no event may payment of either principal or interest exceed the useful life of any asset financed”
 - Timing for principal and interest payments
 - “must require specific justification for each deferral—it may not, however, permit blanket approval”
 - Use of credit enhancement



Recommendations

Types of Debt

- Source of debt service:
 - General obligation from tax revenues
 - Revenue or fee backed
- Instrument: bonds, notes, commercial paper, loan agreements, interfund loans, capital leases



Recommendations

Types of projects to fund with debt.

- Capital projects
- Working capital



Recommendations

- Process and responsibilities
- Structuring
- Issuance
 - Forward Purchase Agreement- compliance with SFB Guidelines
- Management and monitoring
- Refundings
- Policy review process and amendment



Issues and Considerations: Derivatives

If permit derivative or synthetic debt products:

- Circumstances and restrictions
- Professionals: Swap Advisor, Swap Counsel
- Compliance with SFB Guidelines

<http://www.comptroller1.state.tn.us/sl/pdf/SFBGuidelines10-9Final.pdf>

- III.D.- Conditions Precedent
- IV.- Specifics for Request for Letter of Compliance



Debt Management Policies

**How to start the process for
development of a debt
management policy?**



Process

- Determine existing policies and practices related to finance transactions, budgeting, capital improvement, and transparency
 - Official and unofficial
- Identify applicable debt laws and regulations
- Identify key players (and stakeholders)
- Determine location of existing records



Process

- Gather entity information
 - Transcripts for prior and outstanding debt
 - CAFR
 - Governing Body minutes
 - Rating reports

- Determine prior community meetings or charettes

- Develop a schedule



Attachment B: Resources

Comptroller of the Treasury (<http://www.comptroller1.state.tn.us/sl/index.asp>)

Government Finance Officers Association (GFOA) (www.gfoa.org)

Municipal Technical Advisory Service (<http://www.mtas.tennessee.edu/>)

County Technical Assistance Service (<http://www.ctas.utk.edu/>)

Rating Agencies:

- a) Fitch Ratings (www.fitchratings.com)
- b) Moodys (www.moodys.com)
- c) Standard & Poors (www.standardandpoors.com)

Municipal Securities Rulemaking Board (www.msrb.org)

- Electronic Municipal Market Access (www.emma.msrb.org)

Securities Industry and Financial Markets Association (www.sifma.org)

- Investing in Bonds (<http://investinginbonds.com/>)



We're Here to Help 😊

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<http://www.comptroller1.state.tn.us/sl/index.asp>

Additional contact:

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