

DEBT MANAGEMENT and POST-ISSUANCE COMPLIANCE POLICY FOR CITY OF CHEHALIS, WASHINGTON

This Debt Management and Post-Issuance Compliance Policy ("Debt Management Policy") is intended to guide decision making about debt financing and ensure post-issuance compliance for tax-exempt debt issuances made by the City of Chehalis, Washington ("City").

I. THE USE OF DEBT:

- Debt should be used to finance assets with substantial useful lives.
- The term of the debt must not exceed the projected useful life of the asset.
- Nothing under \$100,000 should be financed with bonded long-term debt.
- Current operations and maintenance should not be financed with long-term debt.

II. DEBT PLANNING POLICIES:

- The City's financial management policies should be oriented to maintain a balanced relationship between issuing debt and using pay-as-you-go financing.
- The scheduled maturities of long-term obligations should not exceed the expected useful life of the capital project or asset(s) financed.
- In determining which type of bond to issue, the following factors should be considered:
 - a) The direct and indirect beneficiaries of the project. A significantly larger portion of citizens should benefit from projects financed by general obligation bonds.
 - b) The revenues that may be raised by alternative types of user charges.
 - c) The cost-effectiveness and equity of user charges.
 - d) The effect of the proposed bond issue on the City's ability to finance projects of potentially higher priority in the future.
 - e) The interest cost of each type of bond.
 - f) The impact on the City's financial condition and credit rating.
 - g) The additional cost for operations and maintenance or the cost savings that will result from the new facility or equipment.

III. TYPES OF DEBT:

A. General Obligation Bonds:

R.C.W. 39.36.020 limits the City's long-term general obligation debt (this is debt which pledges the full faith and credit of the City for repayment, not just a specific revenue source).

The City is limited to 1.5 percent of the value of taxable property on "councilmatic" bonds, or bonds that can be issued without an election. With the approval of three-fifths of the voters voting at an election held for that purpose, there is a limitation of two and one-half percent of the

value of the taxable property. Whether the debt issued is a combination of "councilmatic" bonds and voter approved bonds, or only voter approved bonds, the two and one-half percent limitation still applies.

The City may, with such approval, become indebted to larger amounts, but not exceeding two and one-half percent each for supplying the City with water or sewer services (utilities), and for acquiring or developing open space and park facilities.

This debt must be repaid from the general operating revenues of the City unless the ballot measure also authorizes an excess property tax levy. In other words, the authority of the City to issue non-voter approved bonds does not imply the authority to exceed property tax limits.

R.C.W. 84.52.056 authorizes the City to levy additional property taxes for capital improvement purposes only (the replacement of equipment is prohibited), and this levy must also be approved by three-fifths of the voters.

Policies for General Obligation Bonds:

- General obligation debt should be used to finance only those capital improvements and long term assets which have been determined to be essential to the maintenance or development of the City.
- General obligation debt should be used only after considering alternative funding sources, such as project revenues, federal and state grants, user fees, and special assessments.
- Bond proceeds should only be used for the following: construction project costs, acquisition of other expensive fixed assets (such as a street sweeper or fire truck), bond issuance costs, and the refunding of outstanding bond issues.
- Annual debt service on non-voted long-term general obligation debt should not exceed 3% of general fund operating revenues.

B. Revenue Bonds:

Revenue bonds are bonds whose principal and interest are payable exclusively from the earnings of an enterprise fund. Revenue bonds are secured by the income of the utility. A rate covenant is established, which pledges that rates will be maintained sufficient to meet the cost of operations and maintenance, pay debt service, create reserves, and meet contingencies. The "debt service coverage" provides a margin of safety for the bond holders. Revenue bond interest rates are usually higher than general obligation bonds, but they don't require voter approval.

Policies for Revenue Bonds:

- A financial feasibility study should be performed for each project to determine whether it is in the best interests of the City to issue debt or use existing reserves.
- Bond proceeds should only be used for the following: project construction costs, acquisition of other fixed assets, bond issue costs, debt service requirements, and refunding of outstanding bond issues.

C. Special Assessment Bonds:

Special assessment bonds are bonds payable from the proceeds of special assessments. They are used for Local Improvement Districts or Utility Local Improvement Districts, which are usually neighborhood-based or which have defined geographic boundaries in any case.

Policies for Special Assessment Bonds:

- Bond proceeds should only be used for the following: project construction costs, acquisition of other fixed assets, bond issue costs, debt service requirements, and refunding of outstanding bond issues.

D. Government Loans:

There exist a wide variety of Federally and State funded loan programs. The listing below is neither intended to be comprehensive nor exhaustive. When contemplating entering into a loan with a government agency, some key aspects of a loan which should be considered: a) whether it is to be a General Obligation debt or a Revenue debt; b) interest rates; c) debt covenants; d) debt maturity; and e) special requirements.

a) CERB Loans:

The state's Community Economic Revitalization Board (CERB) funds public infrastructure that will result in specific private developments or expansions in manufacturing, production, food processing, assembly, warehousing, industrial distribution, recycling facilities, or businesses that substantially support the trading of goods and services outside the state's borders. CERB requires job creation or retention.

Applications must include evidence that a private development or expansion is ready to occur and will only occur if CERB funds are provided.

Applicants must demonstrate that no other timely source of funds is available at reasonable similar rates. Interest rates generally match the most current rate of Washington State bonds but do not exceed 10 percent. The repayment term is up to 20 years.

b) PWTF Loans:

Public Works Trust Fund (PWTF) loans provide financial assistance for a variety of projects.

In the area of planning, capital facilities plans and comprehensive system plans (e.g., water system plans) are eligible for funding. However, these fund are only available for new plans, not for routine updates.

In the area of construction, PWTF loans provide financial assistance for the construction of new or expanded infrastructure facilities (road, bridge, domestic water, sanitary sewer and storm sewer). This construction must meet existing standards.

PWTF loans have an interest rate range from zero to three percent and a maximum loan term of 20 years. To qualify for a reduction on the loan rate, there must be extraordinary financial hardship, significant local financial commitment, or other valid reason.

c) Local Option Capital Asset Lending (LOCAL)

The LOCAL program is an expanded version of the state agency lease/purchase program. The program was originally created by the Legislature in 1989 ([RCW 39.94](#)) to provide the lowest cost financing for state agency purchases by pooling funding needs into larger

offerings of securities. The Legislature passed legislation in 1998 to provide local governments access to the program. Local government agencies of all types can finance equipment or real estate needs through the State Treasurer's office subject to existing debt limitations and financial considerations.

E. Leases

These should only be used as a last resort. They generally carry a higher interest rate and require significant staff time to meet reporting requirements. Therefore, they are not as cost effective as other means of financing.

Policies on Leases:

- The lease must mature prior to the end of the useful life of the equipment.
- A financial analysis must be made to determine that the cost of the lease does not exceed the value of the asset.

Again, this debt ties back to the General Obligation debt. There is a three-quarters of one percent of the value of taxable property limitation on capital leases.

IV. POST-ISSUANCE COMPLIANCE FOR TAX-EXEMPT BONDS

1. Purpose. The purpose of this section on post-issuance compliance (the "Compliance Section") for tax-exempt bonds issued by the City is to ensure that the City will be in compliance with requirements of (i) the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied with respect to such bonds (collectively, the "bonds") after the bonds are issued, and (ii) any continuing disclosure undertakings the City has entered into pursuant to Rule 15c2-12 promulgated by the United States Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, as applicable to a participating underwriter for the bonds.

2. Responsibility for Monitoring Post-Issuance Tax Compliance. The City Council has the overall, final responsibility for monitoring whether the City is in compliance with post-issuance federal tax requirements. However, by Ordinance No. 878-B, the City Manager of the City (the "City Manager") and the Finance Manager of the City (the "Finance Manager"), acting under the direction of the City Manager, are authorized and directed to take any actions and to execute documents as in his or her judgment that may be necessary or desirable to carry out the terms of such ordinance, including the proper application, use and investment of bond proceeds. Accordingly, the Finance Manager undertakes the primary operating responsibility of monitoring compliance with post-issuance federal tax requirements for the bonds, including the implementation of this Compliance Section of the City's Debt Management Policy.

3. Compliance Check Activities and Frequency. As the officer of the City with the operational responsibility of monitoring compliance with post-issuance federal tax requirements for the bonds, the Finance Manager shall, at least every 12 months so long as the bonds remain outstanding:

(a) confirm the City's compliance with the requirements set forth in paragraphs 4, 5 and 6 below;

(b) inquire with the principal officers of those departments of the City for which property is financed with proceeds of bonds as to whether the property has experienced any material change in use that includes "private business use" (as such term is defined in paragraph 5(a) below); and

(c) confirm the City's compliance with its undertaking to provide bondholders with annual financial information and timely notice of the occurrence of certain events, as set forth in the ordinance authorizing the issuance of the bonds.

(d) report, at least annually, to the City Manager on actions taken to ensure compliance with the Compliance Section of this policy.

A copy of this Debt Management Policy shall be kept with other City records that are to be readily accessible to any person or officer of the City succeeding the responsibilities of Finance Manager during the lifetime of any bonds.

4. Arbitrage Yield Restriction and Rebate Requirements. The Finance Manager shall maintain or cause to be maintained records of:

(a) purchases and sales of investments made with bond proceeds (including amounts treated as “gross proceeds” of bonds under Section 148 of the Code) and receipts of earnings on those investments;

(b) expenditures made with bond proceeds (including investment earnings on bond proceeds) in a timely and diligent manner for the governmental purposes of the bonds, such as for the costs of purchasing, constructing and/or renovating property and facilities;

(c) information showing, where applicable for a particular calendar year, that the City was eligible to be treated as a “small issuer” in respect of bonds issued in that calendar year because the City did not reasonably expect to issue more than \$5,000,000 of bonds in that calendar year;

(d) calculations that will be sufficient to demonstrate to the Internal Revenue Service (the “IRS”) upon an audit of a bond issue that, where applicable, the City has complied with an available spending exception to the arbitrage rebate requirement in respect of that bond issue;

(e) calculations that will be sufficient to demonstrate to the IRS upon an audit of a bond issue for which no exception to the arbitrage rebate requirement was applicable, that the rebate amount, if any, that was payable to the United States of America in respect of investments made with gross proceeds of that bond issue was calculated and timely paid with Form 8038-T timely filed with the IRS; and

(f) information and records showing that investments held in yield-restricted advance refunding or defeasance escrows for bonds, and investments made with unspent bond proceeds after the expiration of the applicable temporary period, were not invested in higher-yielding investments.

5. Restrictions on Private Business Use and Private Loans. The Finance Manager, shall adopt procedures authorized by the City Manager that are calculated to ensure that the City complies with rules limiting private business use of bond-financed property by educating and informing the principal operating officials of those departments, including utility departments, if any, of the City (the “users”) for which land, buildings, facilities and equipment (“property”) are financed with proceeds of bonds about the restrictions on private business use that apply to that property after the bonds have been issued, and of the restriction on the use of proceeds of bonds to make or finance any loan to any person other than a state or local government unit.

In particular, following the issuance of bonds for the financing of property, the Finance Manager shall provide to the users of the property a copy of this Compliance Policy and other appropriate written guidance advising that:

(a) “private business use” means use by any person other than a state or local government unit, including business corporations, partnerships, limited liability companies, associations, *nonprofit corporations*, natural persons engaged in trade or business activity, and *the United States of America and any federal agency*, as a result of ownership of the property or

use of the property under a lease, management or service contract (except for certain “qualified” management or service contracts), output contract for the purchase of electricity or water, privately sponsored research contract (except for certain “qualified” research contracts), “naming rights” contract, “public-private partnership” arrangement, or any similar use arrangement that provides special legal entitlements for the use of the property;

(b) under Section 141 of the Code, no more than 10% of the proceeds of any bond issue (including the property financed with the bonds) may be used for private business use, of which no more than 5% of the proceeds of the bond issue (including the property financed with the bonds) may be used for any “unrelated” private business use—that is, generally, a private business use that is not functionally related to the governmental purposes of the bonds; and no more than *the lesser* of \$5,000,000 or 5% of the proceeds of a bond issue may be used to make or finance a loan to any person other than a state or local government unit;

(c) before entering into any special use arrangement with a nongovernmental person that involves the use of bond-financed property, the user must consult with the City Manager and the Finance Manager, provide them with a description of the proposed nongovernmental use arrangement, and they will determine whether that use arrangement, if put into effect, will be consistent with the restrictions on private business use of the bond-financed property;

(d) in connection with the evaluation of any proposed nongovernmental use arrangement, the City Manager and the Finance Manager should consult with nationally recognized bond counsel to the City as may be necessary to obtain federal tax advice on whether that use arrangement, if put into effect, will be consistent with the restrictions on private business use of the bond-financed property, and, if not, whether any “remedial action” permitted under Section 141 of the Code may be taken by the City as a means of enabling that use arrangement to be put into effect without adversely affecting the tax-exempt status of the bonds that financed the property; and

(e) the Finance Manager and the user of the property shall maintain records of such nongovernmental uses, if any, of bond-financed property, including copies of the pertinent leases, contracts or other documentation, and the related determination that those nongovernmental uses are not inconsistent with the tax-exempt status of the bonds that financed the property.

6. Records to be Maintained for Bonds. It is the policy of the City that, unless otherwise permitted by future IRS regulations or other guidance, written records (which may be in electronic form) will be maintained with respect to each bond issue for as long as those bonds remain outstanding, plus three years. For this purpose, the bonds include refunding bonds that refund the original bonds and thereby refinance the property that was financed by the original bonds.

The records to be maintained include:

- (a) the official Transcript of Proceedings for the original issuance of the bonds;
- (b) records showing how the bond proceeds were invested, as described in paragraph 4(a) above;
- (c) records showing how the bond proceeds were spent, as described in paragraph 4(b) above, including purchase contracts, construction contracts, progress payment requests, invoices, cancelled checks, payment of bond issuance costs, and records of “allocations” of bond proceeds to make reimbursement for project expenditures made before the bonds were actually issued;

(d) information, records and calculations showing that, with respect to each bond issue, the City was eligible for the “small issuer” exception or one of the spending exceptions to the arbitrage rebate requirement or, if not, that the rebate amount, if any, that was payable to the United States of America in respect of investments made with gross proceeds of that bond issue was calculated and timely paid with Form 8038-T timely filed with the IRS, as described in paragraphs 4(c), (d) and (e) above; and

(e) records showing that special use arrangements, if any, affecting bond-financed property made by the City with nongovernmental persons, if any, are consistent with applicable restrictions on private business use of property financed with proceeds of tax-exempt bonds and restrictions on the use of proceeds of bonds to make or finance loans to any person other than a state or local government unit, as described in paragraph 5 above.

The basic purpose of the foregoing record retention policy for the bonds is to enable the City to readily demonstrate to the IRS upon an audit of any bond issue that the City has fully complied with all federal tax requirements that must be satisfied after the issue date of the bonds so that those bonds continue to be eligible for the applicable tax exemption under the Code.

7. Identification and Remediation of Potential Violations of Federal Tax Requirements for Bonds. If at any time during the life of an issue of bonds, the City discovers that a violation of federal tax requirements applicable to that issue may have occurred, the the City Manager and/or Finance Manager will consult with bond counsel to determine whether any such violation actually has occurred and, if so, take prompt action to accomplish an available remedial action under applicable Internal Revenue Service regulations or to enter into a closing agreement with the Internal Revenue Service under the Voluntary Closing Agreement Program described under Notice 2008-31 or other future published guidance.

8. Education Policy With Respect to Federal Tax Requirements for Tax-Exempt Bonds. As authorized by the City Manager, it is the policy of the City that the Finance Manager and his or her staff, as well as the principal operating officials of those departments of the City for which property is financed with proceeds of bonds, should be provided with education and training on federal tax requirements applicable to bonds. The City recognizes that such education and training is vital as a means of helping to ensure that the City remains in compliance with those federal tax requirements in respect of its bonds. The City therefore will enable the Finance Manager to attend and participate in educational and training programs offered by, among others, the Washington Finance Officers Association with regard to the federal tax requirements applicable to bonds. The Finance Manager will provide training to staff, as appropriate, in order to ensure compliance with tax-exempt federal tax requirements.