City of Roanoke, Virginia

Reserve and Debt Management Policies

November 1, 2010 (Resolution No.39000-110110)
Revised January 3, 2012 (Resolution No. 39290-010312)
Revised November 18, 2013 (Resolution No. 39807-111813)
Revised August 20, 2018 (Resolution No. 41209-082018)

Table of Contents

Goals and Objectives

These policies are designed to help protect the City's financial resources necessary to meet short-term and long-term operating and capital needs by:

- Promoting sound financial management;
- Protecting and maintaining the City's credit ratings;
- Ensuring the legal and prudent use of the City's debt issuance authority; and
- Guiding the City and its managers in policy and debt issuance decisions.

While adherence to this policy is expected in applicable circumstances, the City understands that changes in the capital markets, City programs, or other unforeseen circumstances may from time to time produce situations that are not covered by this policy and will require modifications or exceptions to achieve the policy goals. In these cases, the City's management may act, provided specific authorization from the Director of Finance or City Council is obtained. Failure to comply in any manner with this policy shall not result in any liability on the part of the City to any party.

This policy was adopted by City Council on November 1, 2010 with the adoption of Resolution No. 39000-110110, and revised on January 3, 2012 (Resolution No. 39290-010312), November 18, 2013 (Resolution No. 39807-111813), and August 20, 2018 (Resolution No. 41209-082018). These policies will be reviewed at least every three years by the Director of Finance.

Reserve Policies

Unassigned General Fund Reserve

- **Reserve Floor**— Roanoke will target an unreserved, Unassigned General Fund Reserve equal to a minimum of 12% of General Fund Expenditures. This level of reserves is intended to provide the City with sufficient working capital and margin of financial safety to address unforeseen, one-time expenditure emergencies or significant unforeseen declines in revenues in a specific fiscal year, for which there is no other current budgetary resource available, or other categories of fund balance available to satisfy the funding needed. The Unassigned General Fund Reserve will be reported in the Unassigned category on the City's Governmental Funds Balance Sheet in the General Fund.

- **Reserve Funding Sources** – The Unassigned General Fund Reserve will be maintained through the provision of funding from a budgeted reserve contribution as well as residual revenue in excess of budget, both as necessary, to maintain the designated Reserve Floor.

- **Reserve Drawdown**— Drawdown of the Unassigned General Fund Reserve shall occur only by authorization of City Council. Funds may only be used for the purposes described above, which cannot be covered from contingencies or other sources. The Unassigned General Fund Reserve may not be used for balancing the annual budget due to recurring declines in revenue sources or recurring expenditure increases.

- **Reserve Replenishment**—In the event the Unassigned General Fund Reserve is used, it will be restored to its minimum level within three fiscal years. The Director of Finance will submit a plan in writing to City Council that will restore the Unassigned General Fund Reserve as noted above.

Stabilization Reserve

- **Reserve Floor**— Roanoke will target a Stabilization Reserve equal to a minimum of 3% of General Fund Expenditures. The Stabilization Reserve will be reported in the Unassigned category on the City's Governmental Fund Balance Sheet in the General Fund. This reserve is intended for specific purposes:
  - Coverage for an economic downturn to smooth the financial operations in the event of a recessionary decline in which revenues decline by more than 1.5% of the current year estimate.
  - Coverage for risk exposure that the City has due to its self-insurance program and unanticipated risk management expenses. The City is currently self-insured for Health, Workers' Compensation, General Liability, and Automobile claims.

    - Investments related to Economic and Community Development projects which may provide future growth opportunities and expansion of the tax base in Roanoke. Examples of qualifying uses include, but are not limited to, the purchase of property for economic development, economic development incentives and development of infrastructure to support other economic and/or community development projects.

- **Reserve Funding Sources**—The Stabilization Reserve will be maintained through the provision of funding from:
    - Revenue in excess of budget, as necessary, to maintain and exceed the 3% Reserve Floor
    - Excess debt service funding as recommended by the City Manager and approved by City Council
    - Interest earnings of the Capital Projects Fund
    - Proceeds from the sale of surplus general government real property

- **Reserve Drawdown**— Drawdown of the "Stabilization Reserve" balance below the 3% floor shall occur only by authorization of City Council and will be limited to the purposes noted above. The Stabilization Reserve may not be used for balancing the annual budget due to recurring declines in revenue sources or recurring expenditure increases.

- **Reserve Replenishment**— In the event the Stabilization Reserve is used, it will be restored to its minimum level within three fiscal years. The Director of Finance will submit a plan in writing to City Council that will restore the Stabilization Reserve as noted above.

Reserve Funding Plan

In order to meet the desired reserve levels, the City will concurrently fund the Unassigned General Fund Reserve at the designated 12% level and the Stabilization Reserve at the 3% level as noted below:

By Year-End FY 2019:

- Fund the Unassigned General Fund Reserve at a minimum of 11% of General Fund Expenditures
- Fund the Budget Stabilization Reserve to a level of a minimum of 1/2% General Fund Expenditures

By Year-End FY 2020:

- Fund the Unassigned General Fund Reserve at a minimum of 11 1/2% of General Fund Expenditures

- Fund the Budget Stabilization Reserve to a level of a minimum of 1% of General Fund Expenditures

By Year-End FY 2021:

- Fund the Unassigned General Fund Reserve at a minimum of 12% of General Fund Expenditures
- Fund the Budget Stabilization Reserve to a level of a minimum of 1 1/2% of General Fund Expenditures

By Year-End FY 2022:

- Maintain the Unassigned General Fund Reserve at a minimum of 12% of General Fund Expenditures
- Fund the Budget Stabilization Reserve to a level of a minimum of 2% of General Fund Expenditures

By Year-End FY 2023:

- Maintain the Unassigned General Fund Reserve at a minimum of 12% of General Fund Expenditures
- Fund the Budget Stabilization Reserve to a level of a minimum of 3% of General Fund Expenditures

These Reserve Policies will be reviewed by City staff and the City's Financial Advisor every three years. Recommendations for revisions to the policies will be presented to City Council for consideration.

Debt Management Policy

Introduction

One of the keys to sound financial management is the development of a debt policy. This need is recognized by bond rating agencies as well as the capital markets, and development of a debt policy is a recommended practice by the Government Finance Officers Association. A debt policy establishes the parameters for issuing debt and managing the debt portfolio. It provides guidance to the administration regarding purposes for which debt may be issued, types and amounts of permissible debt and method of sale that may be used. The following debt policy is intended to demonstrate a commitment to long-term financial planning. It will be used in conjunction with the Capital Improvement Programs for both the City and School Board. Adherence to this policy will help assure maintenance of the City's double-A credit ratings.

Guidelines for Debt Issuance

- The City will prepare and update annually a five-year Capital improvement Program (CIP) to be approved by City Council. The CIP will be developed with an analysis of the City's infrastructure and other capital needs, and the financial impact of the debt service required to meet the recommended financing plan. The City will strive to fund at least 10% of the CIP projects' aggregate cost on a cash basis.

- As part of the annual Capital Improvement Program, the Schools shall furnish the City a schedule of funding needs for any school projects for which the issuance of long-term debt is planned.

- Each project proposed for financing through debt issuance will have an analysis performed for review of tax impact and future operating costs associated with the project and related debt issuance costs.

- All proceeds from debt issuance for the City of Roanoke and the City of Roanoke School Board shall be appropriated by City Council.

- Proceeds from the issuance of debt shall be monitored by the investment custodian with regard to arbitrage. Compliance with all applicable federal tax requirements shall be made. The City will coordinate with its investment managers with regard to expected project funds payout so as to maximize investment earnings in light of federal arbitrage requirements. See the City's Post Issuance Compliance Procedures Manual for further details.

- Long-term debt will be issued to purchase or construct capital improvements or equipment with a minimum expected life of five years. The City will not use long-term borrowing to finance annual operating needs. The term of any bond issue will not exceed the useful life of the capital project /facility or equipment for which the borrowing is intended.

- The City will attempt to avoid short-term debt to provide cash flow for annual operations. Debt issued for operating purposes will be limited to cases where there is reasonable certainty that a known source of revenue will be received in the current fiscal year sufficient to repay the debt or where there is a clear financial emergency.

- The City will comply with all applicable U.S. Internal Revenue Service and U.S. Treasury arbitrage requirements for bonded indebtedness in order to preserve the tax-exempt status of such bonds. See the City's Post Issuance Compliance Procedures Manual for further details.

- Bond issues should be planned to minimize the frequency of issuance, thereby ensuring the lowest possible costs of issuance. When determining the size of a bond issue, consideration should be given to the need for construction, debt service and capitalized interest funds. Construction fund draw schedules shall be prepared, and projection of conservative earning on unspent bond funds should be made in conjunction with planning of the City's Capital Improvement Program.

- The decision to use bond proceeds to pay interest during construction for revenue-producing projects shall be made on a case by case basis and shall be based on an evaluation of the opportunity cost of funds and the availability of other sources of funds to pay interest costs.

- General obligation bonds will be amortized on a level principal basis to the extent practical, and revenue bonds will be amortized on a level debt service basis to the extent practical considering the forecasted available pledged revenues.

- The City shall not endorse the obligation of any entity other than the City of Roanoke or Roanoke School Board. However, the City may enter into contracts with other regional or local public entities with respect to public purpose projects, which provide for certain payments when project or entity revenues prove insufficient to cover debt service on obligation issued to finance such project(s). The City will enter into these type agreements only when there is long-term public and financial interest in the regional or local project. The obligation could be structured as Moral Obligation Bonds, or with an underlying support agreement or other contractual arrangement. These obligations do not affect the legal debt limit of the City and any payments are subject to annual appropriation. However, if such payments were made, the obligations would be considered tax-supported debt.

- The City's preferred method of sale of bonds is via competitive sale to underwriters. If deemed advantageous, the City may sell bonds via a negotiated sale, private placement, or other method. Coordination will be made with the City's financial advisor in arriving at a recommendation to issue bonds through a method other than competitive sale.

Underwriter Selection

- **Senior Manager Selection**—The City shall select a senior manager for any proposed negotiated sale. The financial advisor for the City should not be the senior manager on a negotiated sale. The selection criteria shall include, but not be limited to, the following:

  - Ability and experience in managing transactions similar to that contemplated by the City;
  - Prior knowledge and experience with the City;
  - Ability and willingness to risk capital and demonstration of such risk and capital availability;
  - Quality and experience of personnel assigned to the City's engagement;
  - Financing plan; and
  - Underwriting fees.

- **Co-Manager Selection**—Co-managers may be selected on the same basis as the senior manager. The financial advisor for the City should not be a co-manager on a negotiated sale. In addition to their qualifications, co-managers appointed to specific transactions will be a function of transaction size and the necessity to ensure maximum distribution of the City's bonds.

- **Underwriter's Counsel**—In any negotiated sale of City debt in which legal counsel is required to represent the underwriter, the appointment will be made by the Senior Manager with final approval from the City.

- **Underwriter's Discount**—The City will evaluate the proposed underwriter's discount against comparable issues in the market. If there are multiple underwriters in the transaction, the City will determine the allocation of underwriting liability and management fees, if any.

  The allocation of fees will be determined prior to the sale date; a cap on management fees, expenses and underwriter's counsel fee will be established and communicated to all parties by the City. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any additional expenses must be substantiated.

- **Evaluation of Underwriter Performance**—In conjunction with its financial advisor, the City will evaluate each bond sale after completion to assess the following: costs of issuance including underwriters' compensation, pricing of the bonds in terms of the overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credits.

- **Designation Policies**—To encourage the pre-marketing efforts of each member of the underwriting team, orders for the City's bonds will be net designated, unless otherwise expressly stated. The City shall require the senior manager to:

  - Fairly allocate bonds to other managers and the selling group;
  - Comply with Municipal Securities Rulemaking Board (MSRB) regulations governing the priority of orders and allocations; and
  - Within 10 working days after the sale date, submit to the City a detail of orders, allocations and other relevant information pertaining to the City's sale.

Limitations on Level of Debt to be Issued and Outstanding

Constitutional and Statutory Limitations:

- Article VII, Section 10 of the Constitution of Virginia, the Public Finance Act and the City Charter established the City's Legal Debt Margin at 10% if the assessed value of real estate within the City shown by the last preceding assessment for taxes.

- The Public Finance Act and the City Charter also establish other limits as to the amounts and types of debt the City may issue.

Self-Imposed Debt Targets:

- Net tax-supported debt as a percentage of the total taxable assessed value in the City (including real, personal property, and public service corporations) will not exceed 4%. For all of the City's self-imposed debt targets, the City may exclude all or a portion of any bonds or leases that are self-supporting.

- Net tax-supported general obligation debt service shall not exceed 10% of General Fund expenditures.

- Net tax-supported debt will be structured in a manner such that not less than 60% of the aggregate outstanding tax-supported debt will be retired within ten years.

Types of Debt Issuance

- The City may issue general obligation debt for capital or other properly approved projects.

- The School Board may use the Virginia Public School Authority (VPSA), Qualified Zone Academy Bonds (QZAB), Qualified School Construction Bonds (QSCBs), or State Literary Fund loans to finance school capital projects. Such debt issued on behalf of the School Board constitutes general obligation debt of the City. The City Manager and the Director of Finance shall approve any application to the Commonwealth of Virginia for such debt. City Council shall approve the issuance of the bonds as required by the Public Finance Act. The School Board shall approve such financings before requesting City Council approval.

- The City may issue revenue bonds to fund proprietary activities such as water, water pollution control and stormwater utilities, or for other capital projects that generate adequate revenues from user fees to support operations and debt service requirements. The bonds will include written legal covenants which require that revenue sources are adequate to fund annual operating expenses and annual debt service requirements.

- Capital leases may be used to purchase buildings, equipment, furniture and fixtures. The term of any capital lease shall not exceed the useful life of the asset leased. Revenue bonds may be issued by the City or other entity that are secured by a City capital lease.

- Short-term borrowing may be utilized for interim financing or for other purposes as described below. The City will determine and utilize the least costly method for short-term borrowing subject to the following policies:

  - Bond Anticipation Notes (BANs) may be issued for capital related cash purposes to reduce the debt service during the construction period of a project or to provide interim financing for a project. The BANs shall not mature more than 5 years from the date of issuance.
  - Lines of Credit shall be considered as an alternative to other short-term borrowing options.
  - Other Short-Term Debt may be used when such instruments provide an interest rate advantage or as interim financing.

- Lease financing and master lease obligations, including lease revenue bonds, may be considered as alternative financing structures.

- Recognizing both the historical interest rate savings and the risks associated with variable rate debt, the City will limit variable rate debt exposure to approximately twenty percent (20%) of total outstanding debt. Debt service on variable rate bonds will be budgeted at a conservative rate. Prior to issuing variable rate debt, the City will develop a plan to mitigate the associated risks.

- A derivatives policy will be approved before any use of a derivative product.

Refunding of Debt

The City will refund debt when it is in the best financial interest of the City to do so.

- **Debt Service Savings**—When a refunding is undertaken to generate interest rate cost savings, the minimum aggregate present value savings will be 3% of the refunded bond principal amount. The present value savings will be net of all costs related to the financing. If present value savings is less than 3%, the City may consider the refunding efficiency as measured by option value. If the refunding efficiency of a refunding candidate exceeds 70% (on a maturity-by-maturity basis) and present value savings is less that 3%, the City may opt to increase the universe of refunded bonds.

- **Restructuring**—Refundings for restructuring purposes will be limited to restructuring to alleviate debt service during difficult budgetary years, achieve cash flow savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants.

- **Term of Refunding Issues**—The City will refund bonds within the term of the originally issued debt. However, the City may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible. The City also may 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.

- **Escrow Structuring**—The City shall utilize the least costly securities available in structuring refunding escrows. If open market securities are used, a certificate will be provided by a third party agent stating that the securities were procured through an arms-length, competitive bid process that was consistent with the Federal guidelines established for the procurement of investments for escrows, and that the price paid for the securities was reasonable. Under no circumstances shall an agent or financial advisor sell escrow securities to the City from its own account.

- **Arbitrage**—The City shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refundings. Any resulting positive arbitrage will be rebated as necessary according to Federal guidelines. See the City's Post Issuance Compliance Procedures Manual for further details.

Investor Relations, Disclosure and Communication

- The debt ratios outlined above will be computed annually and reported in the Comprehensive Annual Financial Report, along with a computation of net tax-supported debt per capita.

- The City will maintain communication with bond rating agencies to keep them abreast of its financial condition by providing them the City's Comprehensive Annual Financial Report, Annual budget, and Capital Improvement Program.

- The City will comply with all of its undertakings in accordance with Securities and Exchange Commission Rule 15c2-21. See the City's Post Issuance Compliance Procedures Manual for further details.

Debt Service Fund Balance

- The fund balance of the Debt Service Fund shall be reserved for the future payment of annual principal and interest payments, which includes general obligation bonds of the City, including school debt.

Glossary

Advance Refunding. A refinancing transaction in which new (refunding) bonds are issued to repay (refund) outstanding bonds more than 90 days prior to the first call date. The proceeds of the refunding bonds are deposited in an escrow account, invested in government securities, and used to pay debt service (interest, principal and premium, if any) on the refunded bonds through the applicable call date. For accounting purposes, refunding obligations are not considered a part of an issuer's debt.

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.

Bond Anticipation Notes (BANs). Notes that are issued to provide interim financing during project construction and are paid from the proceeds of the issuance of long-term bonds. Typically issued for capital projects.

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.

Capital Lease. A lease obligation that has met the criteria to be categorized as a capital lease as opposed to an operating lease under generally accepted accounting principles.

Competitive Sale. A method of sale where underwriters submit proposals for the purchase of a new issue of municipal securities and the securities are awarded to the underwriter or underwriting syndicate presenting the best bid according to stipulated criteria set forth in the notice of sale.

Continuing Disclosure. Disclosure of financial information deemed to be material with respect to the issuer's ability to repay the principal and interest of a public offered obligation. See the City's Post Issuance Compliance Procedures Manual for further details.

Debt. Any obligations of the City for the payment of money issued pursuant to the Public Finance Act of Virginia.

Derivative. A product, whose value is derived from an underlying security, structured to deliver varying benefits to different market segments and participants. The term encompasses a wide range of products offered in the marketplace including interest rate swaps, caps, floors and other synthetic variable rate products.

Designation Policies. During a negotiated sale, the policy for how investor orders are filled when a maturity is oversubscribed (i.e., when investor demand exceeds bonds available for sale). 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 in a refunding.

General Obligations. Bonds issued by the City secured by the City's pledge of its full faith and credit and unlimited taxing power.

Group Net Orders. An order at the initial offering price. A group net order benefits all underwriting group according to their percentage participation in the account.

Intergenerational Equity. Equity or fairness principal that those that benefit from a capital improvement should pay for it.

Legal Debt Margin. The amount of federal obligation bonds and certain other interest bearing obligations (other than revenue bonds) that the City may have outstanding expressed as a percentage of the assessed value of real estate in the City as shown on the last preceding assessment for taxes.

Member Order. An order submitted by a member of the underwriting group.

Negotiated Sale. A method of sale in which the issuer chooses one underwriter to negotiate terms pursuant to which such underwriter will purchase and market the bonds.

Net Designated Order. An order submitted by an underwriting team member on behalf of an investor on which all or a portion of the underwriting fee is to be credited to certain members of the underwriting team. The investor directs the percentage of the total designation each member will receive.

Option Value. Option valuation is a methodology for evaluating the efficiency of a refunding. Option valuation calculates the maximum theoretical value of refunding a bond, then expresses the current refunding savings as a percentage of the maximum theoretical savings.

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.

Refunding. A transaction in which the City refinances an outstanding issue by issuing new (refunding) bonds and using the proceeds to immediately retire the old (refunded) bonds.

Revenue Bonds. Bonds issued by the City secured by a specific revenue pledge of rates, rents or fees.

Tax -Supported Debt. Debt that is expected to be repaid from the general fund tax revenues of the City. This includes general obligation bonds, appropriation-supported bonds, capital leases and in certain circumstances moral obligation bonds. For the purpose of this Debt Policy, net tax-supported debt includes general obligation debt for the City and School Board, certain bonded capital leases, and any moral obligation bonds for which the City has deposited funds to a debt service reserve fund as requested to replenish such reserve fund.

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. An interest rate, sometimes referred to as a "floating rate," on a security that changes at intervals according to market conditions or a predetermined index or formula.