Special Study of Santa Clara County Debt

Prepared for the Board of Supervisors of the County of Santa Clara

December 1, 2021

Prepared by the

Board of Supervisors Management Audit Division

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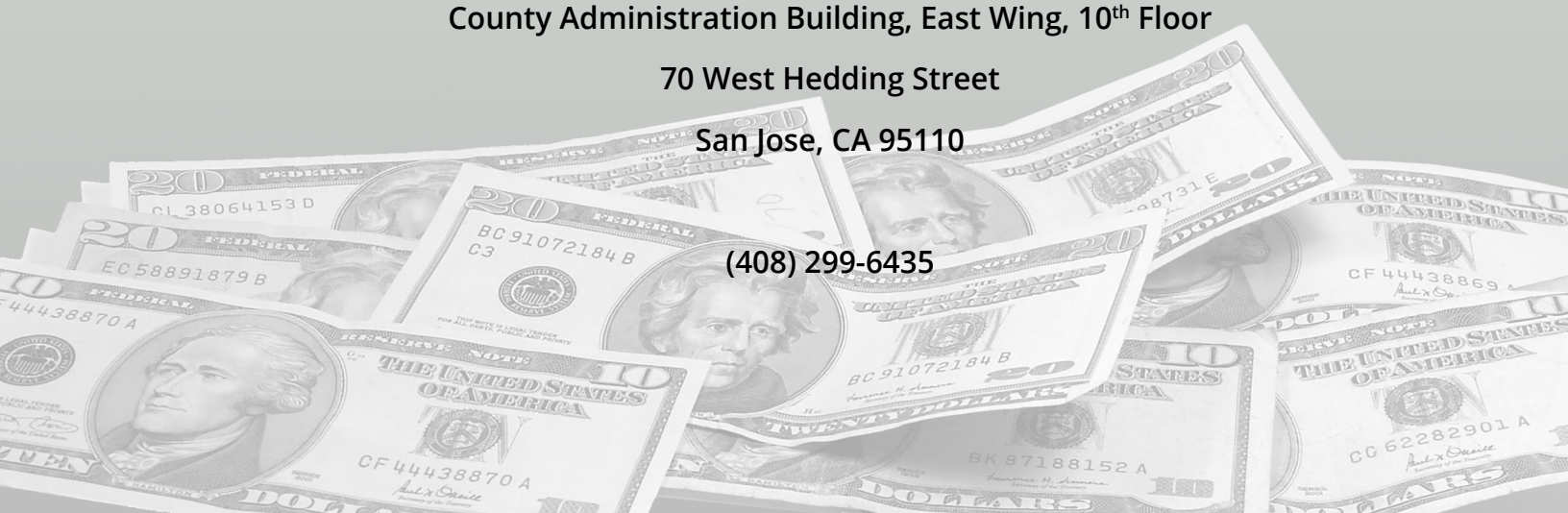

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County of Santa Clara

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December 1, 2021

Supervisor Otto Lee, Chair
Supervisor Cindy Chavez, Vice Chair
Board of Supervisors' Finance and Government Operations Committee
70 West Hedding Street San Jose, CA 95110

Dear Supervisors Lee and Chavez:

We have completed the Special Study of the County's debt issuances and debt management practices. This study was added to the Management Audit Division's FY 2020-21 work plan by the Board of Supervisors of the County of Santa Clara, pursuant to the Board's power of inquiry specified in Article III, Section 302(c) of the Santa Clara County Charter. This study was conducted in conformity with generally accepted government auditing standards as set forth in the 2018 revision of the "Yellow Book" of the U.S. Government Accountability Office. The purpose of this study was to examine the County's debt issuances and debt management practices in order to identify opportunities for issuing and administering the County's debt more efficiently.

The report includes five findings and 16 recommendations related to transparency and oversight, debt-management policy, reliance on lease revenue bonds, internal management, and the use of advisors.

In the attached responses to this audit, the County Executive partially agrees with the one recommendation directed to the Office of the County Executive. The County Director of Finance agrees with six recommendations and partially agrees with four recommendations directed to the Finance Agency. The Budget Director partially agrees with the one recommendation directed to the County Budget Director. Four recommendations are directed to the Board of Supervisors.

If implemented, the recommendations would:

- Increase the transparency and oversight of the County's debt issuance process.
- Reduce the risk of injudicious or unnecessary use of debt, poorly structured debt or repayment schedules.
- Assist policymakers in evaluating proposed debt issuances to minimize County costs and understanding the County's debt portfolio performance overall.
- Ensure that the County considers all opportunities to finance public projects at the lowest costs.
- Align the County with best practices and minimize debt-issuance costs.

We would sincerely like to thank the staff at the Finance Agency (particularly the Debt Management Unit), the Office of Budget and Analysis, the County Executive's Office, and the Facilities and Fleet Division for their thoughtful, patient, and professional cooperation and assistance throughout this study.

Respectfully submitted,

Cheryl Solov
Management Audit Manager

CC:

Supervisor Susan Ellenberg
Supervisor S. Joseph Simitian
Supervisor Mike Wasserman
James R. Williams, County Counsel

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Executive Summary

Section 1: Debt Issuance Transparency and Oversight

The County's Administrative Capital Committee receives and evaluates requests for capital projects from County departments and centrally oversees the development of the 10-Year Capital Improvement Plan (CIP). The County Budget Director, who co-chairs this committee, proposes recommendations to the County Executive, who makes formal recommendations related to capital projects in the CIP and proposed project funding levels in the Recommended Budget. Appropriations for capital projects are approved annually by the Board of Supervisors, and projects that require debt financing are brought before the Board of Supervisors prior to issuance for approval of the bond sale.

The Finance Agency is responsible for management of the County's debt and administration of the Board's Debt Policy, which seeks— among other goals—to minimize the cost of debt issuance. Although Administrative Capital Committee meetings reportedly include representatives of the Finance Agency, coordination between those developing the CIP & Recommended Budget and those administering County debt is informal, rendering the process for selecting and evaluating capital projects that require debt financing opaque.

County officials consider the Board of Supervisors the ultimate decision-maker for the County in matters of debt issuance, but proposed debt issuances are not first heard and discussed in the County's Finance and Government Operations Committee (FGOC), and unlike many peer counties, Santa Clara County has not established a debt advisory or oversight committee to review potential financings and make appropriate recommendations to the Board of Supervisors.

The County Executive should formally establish requirements for the Administrative Capital Committee. The Board of Supervisors should amend the Rules of the Board to include a review of proposed debt issuances as a responsibility of the FGOC and consider establishing an independent oversight body. The Director of Finance should review, revise, and begin using the County's Debt Affordability Model to evaluate the long-term affordability and budgetary impacts of proposed issuances, and the Budget Director should include detailed information about proposed debt issuances and the strategic context of the debt portfolio in the Recommended Budget and the 10-Year Capital Improvement Plan.

Section 2: Debt Management Policy and County Performance

Santa Clara County's Debt Management Policy (Board Policy 4.7.1) was adopted in September 2003 and most recently amended in September 2017. The goal of the Debt Management Policy is to establish debt management objectives and the overall parameters for issuing and administering the County's debt.

The County's Debt Management Policy does not contain all the elements recommended by the Government Finance Officers Association (GFOA) as best practice for debt management policies, and the Debt Management Policy does not establish any practical limit to the amount of debt the County may incur. As a result, there is no prescriptive limit to the amount of debt Santa Clara County may incur: while the State establishes a legal limit of debt for the County, this limit is too high to function practically as a debt limitation. Further, the legal debt limit also does not apply to lease revenue bonds, which are a major source of the County's debt financing. When compared to a group of peer California counties, Santa Clara County has fewer controls on debt levels, as well as a higher debt burden across a variety of metrics.

Without detailed and thorough debt management policies as recommended by GFOA, the County is at an elevated risk of injudicious or unnecessary use of debt and poorly structured debt or repayment schedules, which could result in regulator penalties, credit rating agency downgrades and resulting borrowing cost increases, and a lack of investor and taxpayer confidence.

Board Policy 4.7.1.2(B)(1) states that the Finance Agency is responsible for an annual review the County's Debt Management Policy. Accordingly, the Finance Director should review and propose revisions for consideration by the Board of Supervisors to the County's Debt Management Policy to incorporate all elements recommended by GFOA as best practice for debt management policies. These elements should include, but not be limited to debt limits, debt structuring practices, debt issuance practices, debt management practices, and the County's use of derivatives.

Section 3: Reliance on Lease Revenue Bonds

The two long-term financing instruments most commonly used by California counties are general obligation bonds and lease revenue bonds. Santa Clara County has relied more heavily on lease revenue bonds for financing, primarily because the process for issuing these bonds is typically simpler and more time-efficient (they do not require voter approval). However, lease revenue bonds carry higher costs to the borrower, due to the higher risk for investors, which credit rating agencies typically rate less favorably than general obligation bonds.

Since FY 2012–13, the County's annual costs of debt issuance have ranged from $300,000 to $1.6 million. Despite the higher cost of financing with lease revenue bonds, which was clearly documented in a report to the Board of Supervisors in 2016 that showed over $40 million in increased debt service to fund a $250 million capital project, County officials have noted that the cost differential bears less significance in Santa Clara because the County has received high ratings from the major credit rating agencies.

Santa Clara's reliance on lease revenue bonds, as measured by lease revenue bonds as a percentage of total governmental debt, was higher than the median for the 10 most populated California counties. As discussed in Section 2 of this report, the County's debt management policy does not include specific borrowing thresholds for different financing instruments, including lease revenue bonds. Currently there is no control in place to constrain the County's issuance of lease revenue debt. If revenues were to be impacted by changing economic conditions or increased pressure on the General Fund to support hospital operations, it could raise the risk that credit rating agencies will lower the County's ratings.

In order to minimize General Fund costs for financing and to preserve the County's currently high credit ratings, the Finance Director should establish clear thresholds and guidelines for borrowing on all debt instruments. The Finance Director should also present detailed financing scenarios to the Board of Supervisors when prospective debt issuances are under consideration. These scenarios should include multiple instruments and long-term costs implications that reflect ongoing operating costs.

Section 4: Internal Management

Best practice for post-issuance debt management, as defined by the Government Finance Officers Association (GFOA), calls for formalized and documented policies and procedures to assist bond issuers in complying with laws and regulations.

Despite the significant and growing debt burden under its purview, the County has not reviewed or updated its Debt Internal Control policies and procedures since 2017. It is unlikely that current staff have received any training on the County's existing "Debt Internal Control" policies, as this document was not provided to the project team until two weeks after the exit conference, despite requesting all debt management policies at the entrance conference, in the initial request for information, and in subsequent interviews with staff.

Although our review of practices, including a sample of transactions, indicates that internal controls exist, the lack of formalization leaves the County at an elevated risk of violations, particularly in the event of staff turnover. Examples of violations that the County is at risk for include failure to meet disclosure obligations and missed debt service payments. The County risks regulator penalties, credit rating agency downgrades, and higher costs of borrowing without sufficient policies and procedures in place.

To protect the County from the risks of non-compliance, we recommend that the Finance Agency Director update and expand the internal policies and procedures for post-issuance debt management, including at a minimum all recommendations from the GFOA, and ensure that all current and future staff responsible for debt administration and management receive adequate training on these policies and procedures.

Section 5: Use of Advisors

In accordance with best practice, as established by the Government Finance Officers Association (GFOA), the County contracts out for financial advisory services to provide expertise in structuring and issuing bonds.

While engaging the services of a financial advisory firm to support bond issuances aligns with best practice, the County's process for selecting and managing this firm do not align with GFOA best practice. As noted in GFOA guidance, "finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable." The County has contracted with the same financial advisory firm for public finance projects since at least 2011. Although this firm has been selected through a competitive bid process, the County's request for proposals required that bidders provide both an hourly fee schedule and a proposed flat-fee schedule for services related to the issuance of bonds. According to the contract, the firm did not provide this schedule of fees,

which are not accounted for in the not-to-exceed amount in the most recent contract. This contract established a not-to-exceed amount for financial advisory services of $240,000, but the firm has received over $1 million as of June 2021—most of which was for bond issuance transaction fees. The true costs of these financial advisory services are not reflected in the contract, and it does not appear that the County has made any attempt to reduce costs for these financial services.

To align with best practices and ensure that debt issuance costs are minimized, the Finance Agency Director should require that all future bidders for debt issuance financial advisory services provide schedules reflecting the range of potential transaction fees in their proposals to the County, which should then be reflected within the final terms of the contract.

Introduction

This Special Study of the County's debt issuances and debt management practices was added to the Management Audit Division's Fiscal Year 2020–21 work plan by the Board of Supervisors, pursuant to the Board's power of inquiry specified in Article III, Section 302(c) of the County of Santa Clara Charter. The Board added this study after considering the annual County-wide audit risk assessment conducted by the Management Audit Division in accordance with Board policy.

PURPOSE, SCOPE, AND OBJECTIVES

The purpose of this study was to examine the County's debt issuances and debt management practices in order to identify opportunities for issuing and administering the County's debt more efficiently. This study includes an analysis of the County's level and mix of debt; the organizational structure around debt issuance decision-making and debt management; and a best practices survey.

Work on this study began with an entrance conference on November 18, 2020, and a draft report was issued to the Controller-Treasurer Department on September 24, 2021. We also sent the draft report to the Office of the County Counsel, and relevant sections of the draft report to the Finance Agency and Office of Budget and Analysis.

An exit conference was held with the Finance Agency and the Office of Budget and Analysis on October 7, 2021 and a revised draft incorporating feedback from the exit conference was provided to the Finance Agency and the Office of Budget and Analysis for written response. This final report includes those written responses as Attachment A on page 75.

METHODOLOGY

Although this was not a performance audit, we conducted this study in compliance with generally accepted government auditing standards (GAGAS) issued by the U.S. Government Accountability Office (2018 revision). These standards require that we plan and perform the engagement to obtain sufficient evidence to provide a reasonable basis for our findings and recommendations. The primary difference between a performance audit and a special study is that we are not required to search for fraud as part of a special study, but we are required to do so as part of a performance audit. Regardless, we would report instances of fraud if we had discovered evidence of it.

We interviewed County employees in the Controller-Treasurer Department, the Office of Budget and Analysis, the County's Finance Agency, and the Facilities and Fleet Department, as well as members of the Board of Supervisors and their staff.

We reviewed County policies and procedures, debt reports, analysis prepared by the County's financial advisor, records of reimbursement paid with debt proceeds, consultant contracts and fees, and reports presented to the Board of Supervisors.

We also conducted a best practices survey, which included a review of recommendations set forth by the Government Finance Officers Association (GFOA), a leading industry organization that offers government agencies guidance related to debt issuance and management, to determine the County's consistency with the GFOA standards.

To understand how the County's debt management practices compare with peers, we identified three peer groups: (1) the 10 most populous California counties; (2) Bay Area counties with populations greater than 500,000; and (3) California counties that have public hospitals. Through surveys and interviews, we collected and reviewed these counties' debt management policies, current debt profiles as presented in annual financial reports, and internal organizational structure to determine how Santa Clara County compares to its peers. This includes a comparison of the County's debt load to the peer counties.

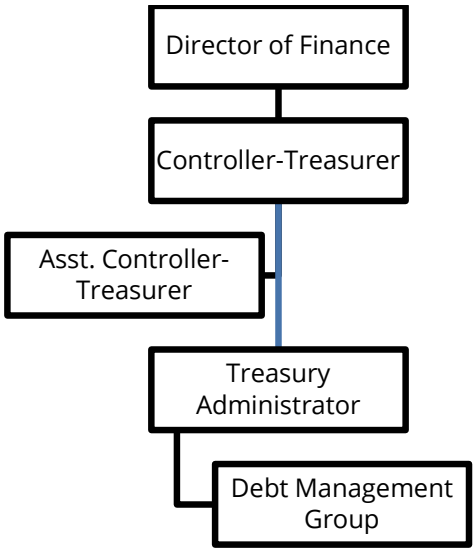
We also conducted a 10-year analysis of the County's debt issuances to evaluate trends and identify opportunities for savings.

DEBT MANAGEMENT IN SANTA CLARA COUNTY

As defined in Board Policy 4.7, the County can issue long-term debt to finance major capital improvements. The types of debt covered by this policy include general obligation bonds, lease revenue bonds, other revenue bonds and certificates of participation. According to the policy, prior to the issuance of debt, the County must identify a reliable revenue source to secure repayment. Cost savings are not a revenue source for the purposes of securing debt repayment.

County Debt Management Structure

The Controller-Treasurer Department has oversight of the County's debt management program. The Debt Management Group, which reports to the Treasury Administrator, maintains responsibility for the issuance and administration of general obligation bonds, lease revenue bonds, Securities Exchange Commission/Internal Revenue Service requirements, credit rating policies/strategies, and other debt financing activities. Below is a chart detailing the organization of the debt management group within the County administration.



While the Debt Management Group issues and administers debt, the decisions regarding when and what type of debt to issue are made through the County's capital planning and budgeting process.

The County's Administrative Capital Committee (ACC) plays a key role in evaluating capital facility requests from departments and reviewing cost estimates developed by the Facilities and Fleet Department. The Office of Budget and Analysis plays a key role in debt financing by proposing funding strategies to the County Executive.

The ACC receives and evaluates requests for capital projects from County departments, and the County Budget Director provides recommendations to the County Executive, who determines the need for debt financing for prospective projects. Appropriations for capital projects are approved annually by the Board of Supervisors; information from the Capital Improvement Plan is presented in the County Executive's Recommended Budget in May, which outlines the recommended capital appropriations for the immediately upcoming fiscal year. The Board approves the County's yearly capital funding upon reviewing the Recommended Budget.

TYPES AND PURPOSES OF DEBT

According to the California Debt and Investment Advisory Commission (CDIAC), the market for debt products sold by government agencies is arranged around three factors: (1) the term of the debt obligation; (2) the credit strength of its source of repayment; and (3) the strength of the debt covenants. Government agencies use both short-term and long-term debt, with either fixed or variable interest rates, to finance capital projects. The benefits and risks of various debt financing structures is described below and summarized in Figure I.1 on page 9.

Short-Term Debt Financing

Short-term debt is typically defined as debt with a term to maturity of less than five years. This type of debt primarily benefits government agencies with limited access to cash in order to finance operating costs. Short-term debt can be used to cover cash flow deficits to finance operating costs, to acquire vehicles and equipment, and to provide interim financing to support ongoing capital projects.

Tax and Revenue Anticipation Notes (TRANs) are one type of short-term debt commonly used to fund operating cash flow deficits in a fiscal year. TRANs proceeds may be used and expended for any purpose, including current operating expenses, capital expenditures, and repayment of debt.

Santa Clara County has not issued short-term debt since FY 2013–14.

Long-Term Debt Financing

Long-term debt typically refers to debt with a term to maturity of greater than five years. Government agencies issue long-term debt to finance the acquisition, preservation, and/or construction of major capital projects. Agencies do not use long-term debt financing to cover operating costs or operating deficits.

The principal types of debt instruments used by California counties to finance long-term capital projects are general obligation bonds, lease revenue bonds, and certificates of participation. Counties also issue taxable pension obligation bonds to pay some, or all, of a pension plan's unfunded liability.

General Obligation Bonds:

General obligation (GO) bonds are securities guaranteed by the "full faith and credit" of a government with taxing power, payable from ad valorem taxes on real property. Tax rates are established annually at levels necessary to generate amounts sufficient to pay debt service. These bonds typically are used to finance capital improvement projects that benefit the general public, such as libraries, affordable housing and parks. With these bonds, the bond issuer pledges to use its general taxing power to repay the bondholders. Voters must approve general obligation bonds before they are issued because these bonds place a general obligation on all taxpayers to cover bond repayments. In California,[1] authorization to issue GO bonds requires supermajority (two-thirds) voter approval.

Lease Revenue Bonds:

Lease Revenue Bonds (LRBs) are a type of revenue bond sold to investors to raise cash for the financing of capital infrastructure, such as office buildings, convention centers, sports stadiums, and courthouses. Under a lease revenue bond agreement, a lessee (the government agency) pays rent to use the facility, and those rent payments are used to reimburse the investors who purchased the bonds.

Lease financing differs from general obligation bonds in that general obligation bonds are secured by an increase in the property tax rate while lease revenue bonds are secured by public facilities with the debt payment pledged from revenues. Capital markets account for this difference in security and corresponding increased risk associated with a lease revenue bond by charging a higher interest rate. While debt service on lease revenue bonds is higher than on general obligation bonds, local governments use such financing because it does not require voter approval.

Certificates of Participation:

Like lease revenue bonds, certificates of participation (COPs) are used to finance capital projects. Certificates of participation are secured by public facilities, and debt payment is pledged from revenues.

Taxable Pension Obligation Bonds

Pension obligation bonds (POBs) are financing instruments typically used to pay some, or all, of a pension plan's unfunded liability. The bond proceeds are transferred to the issuer's pension system as a prepayment of all or part of the unfunded pension liabilities of the issuer, and the proceeds are invested as directed by the pension system.

Notably, the issuance of pension obligation bonds has been discouraged by the leading industry organization, the Government Finance Officers Association (GFOA), which reaffirmed its guidelines on this as recently as February 2021. According to the GFOA statement:

The reasons for which GFOA recommends that state and local governments do not issue Pension Obligation Bonds (POBs) still remain true regardless of economic cycles:

- The invested POB proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased overall liabilities for the government.

1 California Constitution Article XIIA, Section 1(b)(2) and Section 1(b)(3).

- POBs are complex instruments that carry considerable risk. POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives.
- Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity that could be used for other purposes.
- POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the sponsor's overall costs.
- Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.

Below is a summary of the benefits and risks associated with various long-term financing instruments.

Figure I.1: *Summary of Benefits/Risks of Long-Term Financing Instruments*

Type of Financing	Benefits	Risks
GO Bonds	*lower cost *favorable to credit rating agencies	*requires voter approval *can take longer
Lease Revenue Bonds	*voter approval not required so faster process	* more expensive *less favorable to credit rating agencies
Certificates of Participation	*voter approval not required so faster process	* more expensive *less favorable to credit rating agencies
Pension Obligation Bonds	*lowers unfunded pension liability	* more expensive *less favorable to credit rating agencies *GFOA recommends against

REFUNDING BONDS

Bond refinancings or "refundings" can be used by government agencies to achieve debt service savings on outstanding bonds, or to restructure debt service payments.

According to the County's Annual Debt and Swap Report for FY 2019–20, presented to the Board of Supervisors on October 22, 2020, the Debt Management Unit continually reviews and analyzes the outstanding debt portfolio to identify opportunities to refund or restructure bonds in order to reduce annual debt service obligations or convert the bonds to a more financially advantageous structure. The County's Debt Management Policy states that the Debt Unit will determine whether a refunding would produce a net present value savings of at least three percent (3%) of the refunded debt.

Our review indicates that the County has taken advantage of all current refunding opportunities for current outstanding debt.

CREDIT RATINGS

Long-term credit ratings provided by a rating agency offer an independent assessment of the relative credit risk associated with purchasing and holding a particular bond through its scheduled term of repayment. Investors typically consider these long-term credit ratings to be unbiased opinions of a borrower's financial strength and ability to repay its debt on a timely basis, creating a direct impact on the borrowing rates paid by the County.

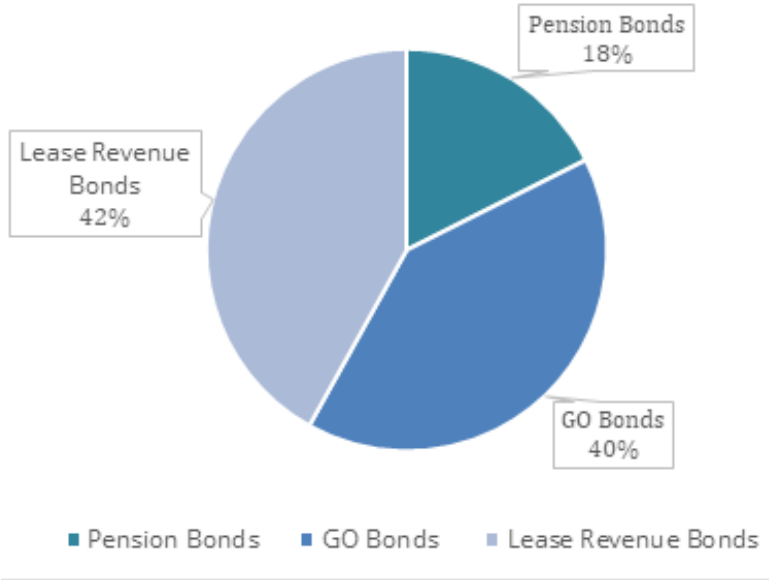
GO Bond ratings are typically one to two notches higher than those of LRBs, because rating agencies consider the credit strength of ad valorem property taxes that are pledged to repay GO Bonds to be superior to the General Fund pledge to repay lease revenue bonds.

The County's credit ratings are discussed in more detail in Section 3, starting on page 47, of this report.

SANTA CLARA COUNTY DEBT PORTFOLIO

As of June 30, 2020, the County had $2.3 billion in outstanding long-term governmental debt.[2] As shown in Figure I.2 below, lease revenue bonds account for the largest share (42 percent) of these obligations.

Figure I.2: *County Outstanding Debt Obligations by Type, as of June 30, 2020*



Source: SCC Audited Financial Statement FY 2019–20.

Since FY 2008–09, the County has issued approximately $3.1 billion in long-term debt, as shown in Figure I.3 on page 11.

2 Because we relied on the County's Audited Financial Statements for most of this analysis, the FY 2021–22 debt issuances are not reflected in most figures in this section, other than Figure I.3 on page 11.

Figure I.3: *County Debt Issuances, FY 2009–2021 (New Issuances and Refundings)*

Fiscal Year	Description	Original Issue Amount			
		New issuance GO	New issuance LRB	Other	Refunding
2008-09	2009 Series A General Obligation Bonds	350,000,000	1		
2009-10	2010 Lease Revenue Bonds Series N				50,110,000
2010-11	2011 Lease Revenue Bonds Series A (QECB)		20,368,000		
2011-12	2011 Lease Revenue Bonds Series B (QECB)		3,639,000		
2012-13	2012 Series A Lease Revenue Bonds		86,919,000		
2013-14	2013 Series B General Obligations Bonds	490,000,000			
2013-14	2014 Series O Lease Revenue Bonds				11,715,000
2014-15	2015 Series P Lease Revenue Bonds				102,435,000
2015-16	2016 New Clean Renewable Energy Bonds			33,000,000	2
2015-16	2016 Series Q Lease Revenue Bonds				168,345,000
2016-17	2016 Series A Lease Revenue Bonds				41,810,000
2017-18	2017 Series C General Obligation Bonds				290,510,000
2017-18	2017 Series A Housing General Obligation Bonds	250,000,000			
2018-19	2018 Series A Lease Revenue Bonds				55,090,000
2018-19	2018 Series A Lease Revenue Bonds		164,355,000		
2018-19	2019 Series A Lease Revenue Bonds		261,100,000		
2018-19	2019 series A Lease Revenue Bonds Taxable		16,080,000		
2021-22	2021 Series A Lease Revenue Bonds		358,165,000		
2021-22	2021 Series B General Obligation Bonds	350,000,000			
	Total Debt Issued Since 2009	**1,440,000,000**	**910,626,000**	**33,000,000**	**720,015,000**
					3,103,641,000
2019-20	2020 Series A Lease Revenue Bonds	29,585,000	3		
					3,133,226,000

Source: SCC Audited Financial Statements for FYs 2009–2020.

Since FY 2008–09, the County's annual debt service[3] has increased from $18.7 million to $80.2 million in FY 2019–20. Measured as a percentage of annual General Fund revenues, the County's debt service has increased from 0.9 percent to 2.3 percent, as shown in Figure I.4 below. Note that this figure differs from the amount shown later in the report's section on Debt Performance Benchmarking and Survey because the latter includes principal and interest paid from all Governmental Funds, not just the General Fund, in the total annual debt service amount.

Figure I.4: *County Debt Service as a Percent of General Fund Revenues, FY 2008–09 to 2019–20*

Fiscal Year	Principal	Interest*	Total Debt Service Payments**	Total Annual GF Revenues	Debt Service as % of GF Rev
2009	9,918,000	8,740,000	18,658,000	2,034,828,000	0.9%
2010	10,799,000	12,742,000	23,541,000	1,975,033,000	1.2%
2011	11,557,000	12,924,000	24,481,000	1,972,165,000	1.2%
2012	12,174,000	14,578,000	26,752,000	1,931,473,000	1.4%
2013	9,332,000	14,375,000	23,707,000	1,981,375,000	1.2%
2014	10,056,000	12,487,000	22,543,000	2,255,023,000	1.0%
2015	10,021,000	11,036,000	21,057,000	2,400,531,000	0.9%
2016	11,238,000	9,561,000	20,799,000	2,679,844,000	0.8%
2017	17,839,000	9,931,000	27,770,000	2,880,220,000	1.0%
2018	32,777,000	23,419,000	56,196,000	2,950,232,000	1.9%
2019	20,990,000	23,918,000	44,908,000	3,235,599,000	1.4%
2020	44,711,000	35,481,000	80,192,000	3,465,585,000	2.3%

Source: SCC Audited Financial Statements for FYs 2009–2020.

Notes:
(*) FY 2010 interest amount includes $117,000 in cost of issuance.
(**) Includes principal and interest expenditures from the General Fund only.

Over the same period of time (FY 2008–09 to FY 2019–20), the County's total debt per capita has increased from $936.65 to $1,317.88. Note that since the completion of our fieldwork for this study, in July 2021, the County issued $350 million in general obligation bonds and $358 million in lease revenue bonds. The resulting increase in the County's total government debt obligation will have a significant impact on the County's debt per capita. We estimate that the FY 2021–22 Audited Financial Statement will reflect 2022 debt per capita closer to $1,600, which is an increase of approximately 81 percent since FY 2008–09. The debt per capita from FY 2008–09 to FY 0219–20 is shown in Figure I.5 on page 13.

3 These debt service amounts shown here do not include the debt service requirements related to the FY 2021-22 debt issuances. According to the official statements for the debt issuances, the average annual debt service will be $18,118,591 for the LRBs and $16,225,805 for the GO bonds.

Figure I.5: *County Total Governmental Debt Per Capita, FY 2009–2020*

Fiscal Year	Government Activities					Business-Type Activities	Total Primary Government Debt	Population	Debt Per Capita
	Pension Bonds	GO Bonds	Lease Revenue Bonds	Certificates of Participation	Capital Leases and Others	Lease Revenue Bonds			
2009	400,044,000	362,173,000	278,260,000	4,279,000	652,000	576,982,000	1,622,390,000	1,857,621	873.37
2010	404,895,000	361,754,000	260,951,000	4,110,000	278,000	560,006,000	1,591,994,000	1,880,876	846.41
2011	409,221,000	346,235,000	264,537,000	3,936,000	459,000	539,440,000	1,563,828,000	1,797,375	870.06
2012	412,963,000	327,717,000	250,177,000	3,758,000	323,000	518,143,000	1,513,081,000	1,816,486	832.97
2013	416,066,000	857,704,000	256,616,000	3,575,000	491,000	573,108,000	2,107,560,000	1,842,254	1,144.01
2014	418,337,000	854,825,000	230,797,000	3,387,000	272,000	541,516,000	2,049,134,000	1,868,558	1,096.64
2015	419,799,000	847,527,000	217,022,000	3,188,000	3,860,000	527,035,000	2,018,431,000	1,889,638	1,068.16
2016	420,365,000	839,150,000	194,774,000	2,984,000	36,347,000	494,037,000	1,987,657,000	1,927,888	1,031.00
2017	419,947,000	829,632,000	588,639,000		35,541,000	56,459,000	1,930,218,000	1,938,180	995.89
2018	418,448,000	1,082,629,000	554,916,000		32,533,000	49,681,000	2,138,207,000	1,956,598	1,092.82
2019	415,771,000	1,014,382,000	995,036,000		29,251,000	42,604,000	2,497,044,000	1,954,286	1,277.73
2020	411,801,000	945,548,000	979,207,000		26,174,000	35,213,000	2,397,943,000	1,961,969	1,222.21

Source: SCC Audited Financial Statements, 2009–2020.

Note that the FY 2020 GO Bond debt amount of $945 million shown in Figure I.5 on page 13 includes $64 million in unamortized premium. Section 2, starting on page 37 of this report references the principal amount of the County's general bonded debt in FY 2020 as $881 million, which is the outstanding amount. We have included interest and premium amounts here and in our comparative analysis in order to be consistent across all jurisdictions.

DEPARTMENT ACCOMPLISHMENTS

Audits and special studies typically focus on opportunities for improvements within an organization, program, or function. To provide additional insight into activities and efforts to improve the County's management of debt, we requested that the Controller-Treasurer and the Office of Budget and Analysis provide some of their relevant noteworthy achievements. These are highlighted as Attachment B on page 85.

RECOMMENDATION PRIORITIES

The priority rankings shown for each recommendation in this report are consistent with the audit recommendation priority structure adopted by the Finance and Government Operations Committee of the Board of Supervisors, as follows:

Priority 1: Recommendations that address issues of non-compliance with federal, State and local laws, regulations, ordinances and the County Charter; would result in increases or decreases in expenditures or revenues of $250,000 or more; or, suggest significant changes in federal, State or local policy through amendments to existing laws, regulations and policies.

Priority 2: Recommendations that would result in increases or decreases in expenditures or revenues of less than $250,000; advocate changes in local policy through amendments to existing County ordinances and policies and procedures; or, would revise existing departmental or program policies and procedures for improved service delivery, increased operational efficiency, or greater program effectiveness.

Priority 3: Recommendations that address program-related policies and procedures that would not have a significant impact on revenues and expenditures but would result in modest improvements in service delivery and operating efficiency.

ACKNOWLEDGMENTS

We would like to thank the staff at the Finance Agency (particularly the Debt Management Unit), the County Executive's Office, and the Facilities and Fleet Division for their assistance with this study.

DEBT PERFORMANCE BENCHMARKING AND SURVEY

Methodology

To compare the County's debt levels and management to that of other counties, we used the benchmarking approach recommended by the Government Finance Officers Association (GFOA). In addition, we surveyed select California counties regarding the organizational structure of their debt management function(s), the number of staff assigned to such function(s), and their financial policies around debt capacity and affordability. Some of the results from this survey appear in other sections of this report.

The two key components that comprise a debt affordability analysis using benchmarking are ratio calculation and comparison to norms and standards. For purposes of this study, we relied on financial ratios commonly applied to counties by two of the major national credit rating agencies (Moody's and Standard & Poor's) and constructed them using information in each peer county's most recently available Audited Financial Statements (June 30, 2020 for purposes of this report). Each rating agency utilizes a unique model to rate the County, but both routinely examine a series of key fiscal measures that consider factors like the local economy, financial performance, and debt.[4]

Research by the GFOA shows that in benchmarking debt statistics, the choice of comparable governments must be done with caution because no two communities are identical. For example, two jurisdictions may be similar in population and bond ratings but very different in terms of economic base and tax structure. Additionally, otherwise similar agencies may have different approaches to funding their capital improvement programs, which are likely to be at different stages.

For this study, we evaluated and compared the County's credit to peer counties in California with populations greater than 500,000 that satisfied one or more of the following criteria: (1) the county is located in the Bay Area; (2) the county is among the 10 most populous in the state; and (3) the county operates a hospital. The unique list of 15 counties (excluding Santa Clara County) that met one or more of these parameters along with the three benchmarking groups they correspond to is shown in Figure M.1 on page 16.

4 Moody's utilizes the principal methodology "U.S. Local Governments General Obligation Debt" that was originally published in January 2014 and re-published in January 2021. S&P utilizes the "U.S. Local Governments General Obligation Ratings: Methodology and Assumptions" originally published in September 2013 and republished in September 2020 with nonmaterial changes.

Figure M.1: *Peer California Counties and Benchmarking Groups*

County Name	Current GO Ratings Moody's/S&P*	I. Bay Area	II. Most Populous	III. Has Hospital**
Alameda	Aaa/AAA	X	X	X
Contra Costa	Aa1/AAA	X	X	X
Fresno	NR/AA-		X	
Kern	Aa3/NR		X	X
Los Angeles	Aa1/AAA		X	X
Orange	Aa1/AA+		X	
Riverside	Aa3/AA		X	X
Sacramento	A1/AA-		X	
San Bernardino	Aa1/AA+		X	X
San Diego	Aaa/AAA		X	
San Francisco	Aaa/AAA	X		X
San Joaquin	Aa2/NR			X
San Mateo	Aaa/AAA	X		X
Stanislaus	A1/AA-			X
Ventura	Aaa/AAA			X
Total:		**4**	**10**	**11**
Santa Clara:	*Aa1/AAA*	*x*	*x*	*x*

Notes:
**Ratings sourced from Audited Financial Statements for Fiscal Year Ending June 30, 2020 and from individual rating agency reports when rating information was not available in audited financial reports.*
***Alameda, Kern, and Stanislaus Counties operate their hospitals through a special authority or district.*

Data Collection

Due to the absence of a standard database of information on debt indicators across jurisdictions, audited financial statements provide the best available source of reasonably comparable debt statistics.

For this study, the project team developed a standard form listing all financial variables required to construct the debt indicators discussed further below. The team reviewed each County's Audited Financial Statements for the Fiscal Year Ending June 30, 2020, and manually entered and analyzed financial data onto the form.

The data for this analysis utilizes Governmental Funds, including the General Fund, and does not consider general obligation or other debt that may be accounted for in enterprise funds or component units of a county government. Santa Clara County does not hold debt in its enterprise fund.

Benchmarking the County's Debt Performance

To understand how Santa Clara County compares to peer counties in terms of its debt burden, we measured the County against each of the three peer groups (defined above) using the following metrics:

- Direct debt to assessed valuation (lower value better)
- Assessed valuation per capita (higher value better)
- Direct debt per capita (lower value better)
- Direct debt as percentage of total governmental fund revenues (lower value better)
- Available General Fund balance as percentage of revenues (higher value better)
- General Fund cash balance as percentage of revenues (higher value better)
- General Fund balance as percentage of revenues (higher value better)
- Total government available cash as percentage of expenditures (higher value better)
- Annual debt service as percentage of General Fund revenues (lower value better)
- Annual debt service as percentage of expenditures (lower value better)

A comprehensive table of the analysis results can be found in Attachment C on page 89 of this report.

In this section, we provide the results of three of the measures evaluated:

1. Direct debt to assessed valuation (lower value better)
2. Direct debt per capita (lower value better)
3. Annual debt service as percentage of General Fund revenues (lower value better)

Note that for all three measures, a lower value indicates a more favorable position.

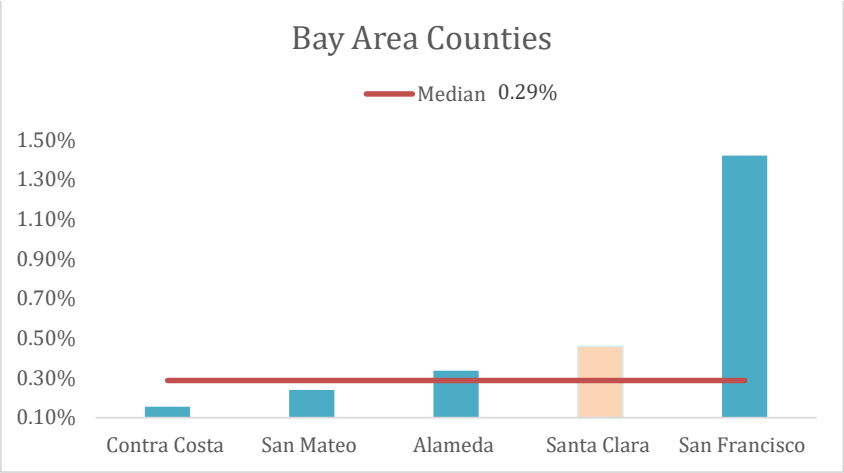
The first debt ratio presented is direct debt to assessed valuation, which measures the amount of the County's debt compared to the total value of assessed property (see Figure M.2 on page 18). Note the figure for direct debt includes General Obligation bonds (GO), Certificates of Participation (COP), Lease Revenue bonds (LRB), and Pension Obligation bonds (POB). It also includes notes, loans, capital leases, and any third-party debt backed by the local government's GO guarantee to the extent these securities are reported under Governmental Activities in the *Ratios of Outstanding Debt by Type* schedule of an agency's audited financial statements. It does **not** include Tobacco Settlement or Securitization bonds, as these obligations are secured by tobacco settlement revenues from participating manufacturers.

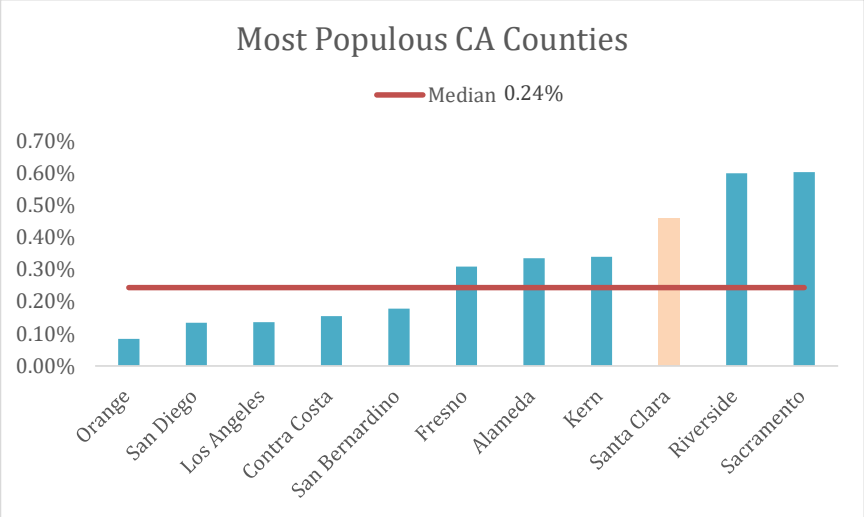
As of June 30, 2020, the County's direct debt to assessed valuation equaled 0.46 percent. The median for the Bay Area County comparison group on this measure is 0.29 percent. As shown in Figure M.1 on page 16, the County had the second highest ratio of direct debt to assessed valuation, with only San Francisco measuring higher. As reported in the full comparison results in Attachment C on page 89, the County has a relatively high assessed value, which positively affects this ratio.

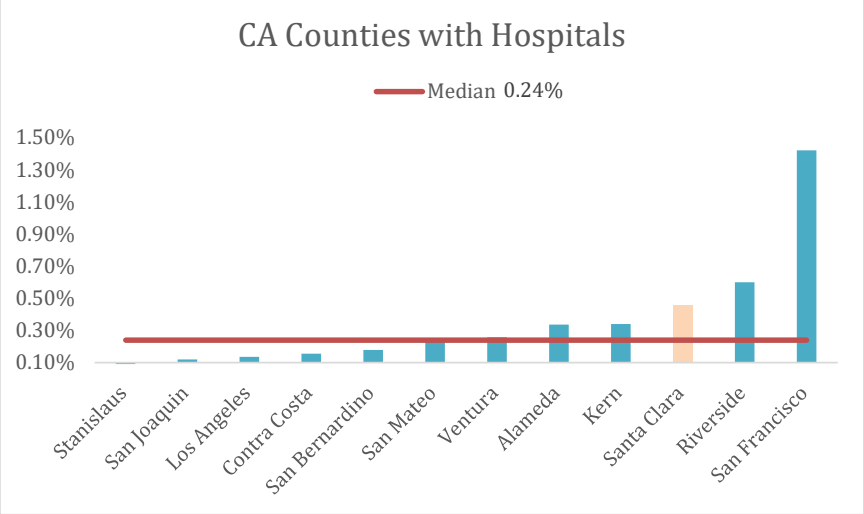
The median ratio for the 10 most populous counties comparison group totaled 0.24 percent, approximately half of the County's 0.46 percent ratio. Among this group, only Riverside and Sacramento had higher ratios.

Similarly, the median ratio for the final peer group of Counties with hospital systems was 0.24 percent. Of this group, only Riverside and San Francisco had higher ratios. Note that Stanislaus County does not have any outstanding public debt except for Tobacco Securitization Bonds.

Figure M.2: ***Direct Debt to Assessed Valuation***







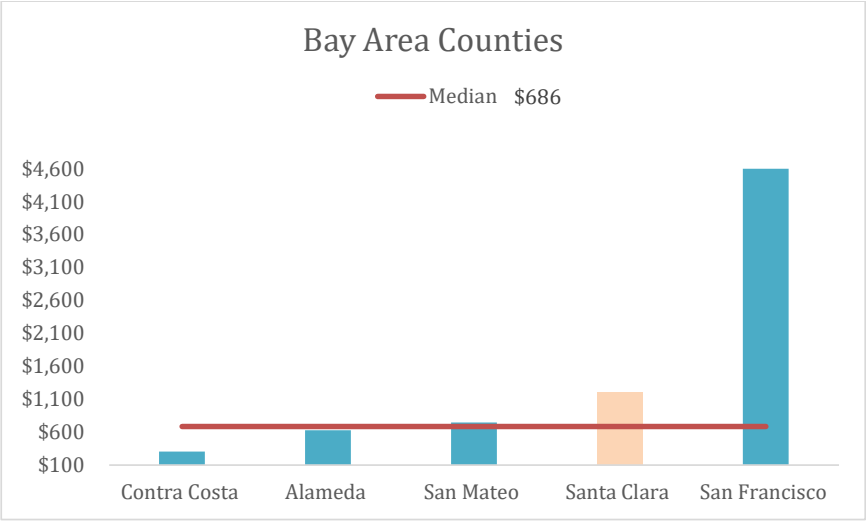
The next debt ratio used to compare with the peer groups was direct debt per capita (see Figure M.3 on page 20). As of June 30, 2020, the County's direct debt per capita equaled $1,204. Note, as discussed in Section 3: Reliance on LRBs, the County's recent debt issuances in 2021 increase direct debt per capita to over $1,500.

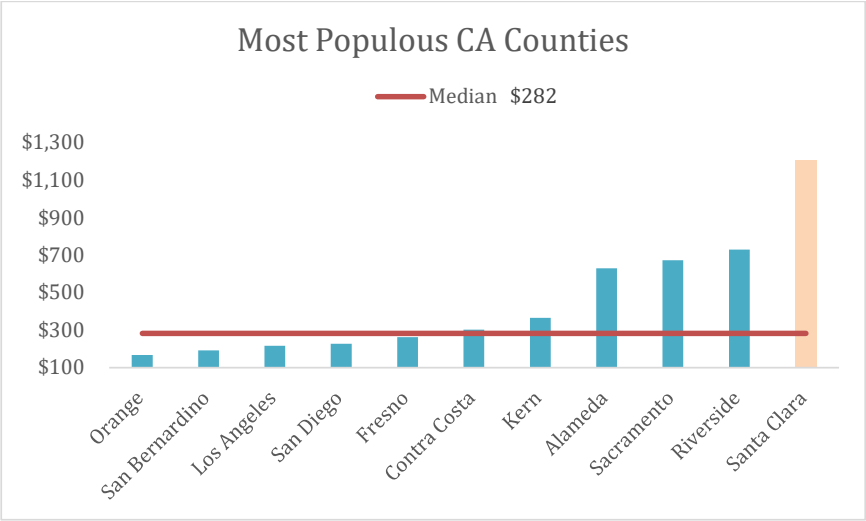
The median for the Bay Area County comparison group on this measure is $686. As shown in Figure M.3 on page 20, the County had the second highest ratio of direct debt per capita, with only San Francisco measuring higher.

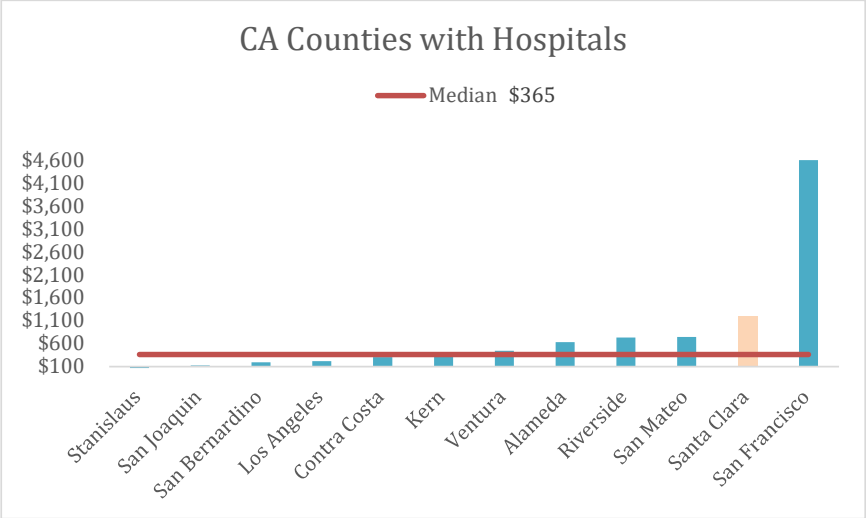
The median ratio for the 10 most populous counties comparison group was significantly lower at $282. No counties had a higher ratio than Santa Clara among this set of peers.

The median ratio for the final peer group of Counties with hospital systems was $365. Of this group, only San Francisco had a higher ratio than Santa Clara County.

Figure M.3: ***Direct Debt Per Capita***







The final debt ratio shown in this section that we used to compare with the peer groups was annual debt service as a percentage of General Fund revenues (see Figure M.4 on page 22). Note the annual debt service amount includes expenditures for principal and interest from all Governmental Funds reported in the *Statement of Revenues, Expenditures, and Changes in Fund Balances* of the Audited Financial Statements.

As of June 30, 2020, the County's annual debt service as a percentage of General Fund revenues equaled 5.2 percent.[5]

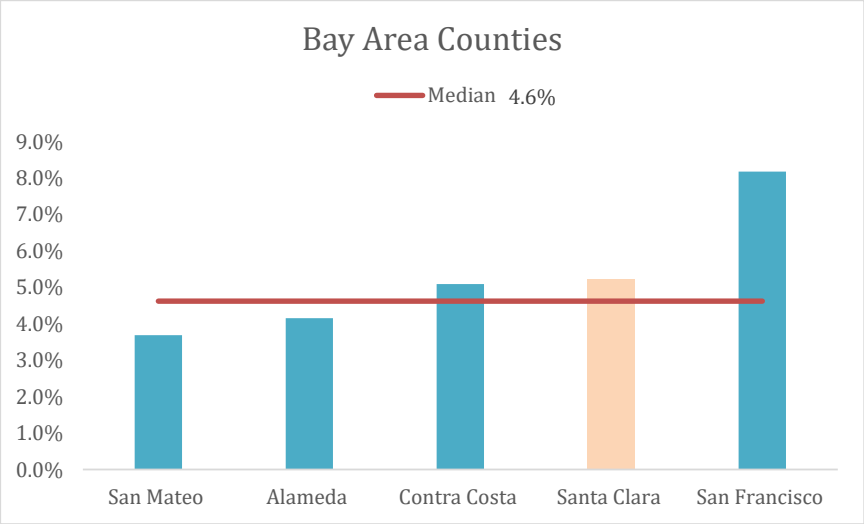
The median for the Bay Area County comparison group on this measure is 4.6 percent. As shown in Figure M.4 on page 22, the County had the second highest annual debt service burden among the peer group, with Contra Costa County trailing closely behind with a ratio of 5.1 percent.

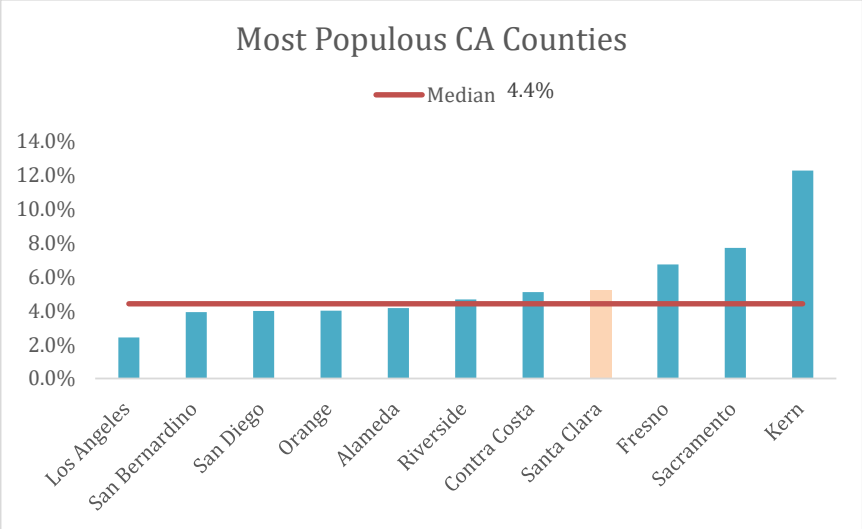
The median ratio for the 10 most populous counties comparison group was 4.4 percent. Fresno, Sacramento, and Kern had higher ratios than Santa Clara among this set of peers.

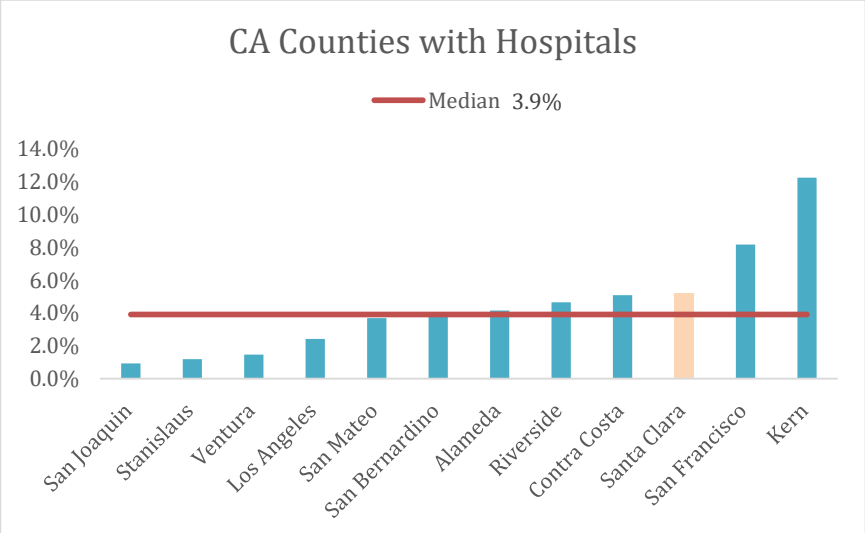
Similarly, the median ratio for the final peer group of Counties with hospital systems was 3.9 percent. Of this group, Kern and San Francisco had higher ratios.

5 This differs from the 2.3 percent reported in Figure I.4 on page 12, which only considers principal and interest expenditures reported for the General Fund.

Figure M.4: *Annual Debt Service as a Percentage of General Fund Revenues*







GLOSSARY OF KEY TERMS

As referenced in the following section on Methodology and throughout this report, below are definitions of the key terms used for our benchmarking comparisons.

- **Annual debt service:** the amount of resources required to cover the repayment of principal and interest on the County's outstanding debt.
- **Assessed valuation:** the County's total taxable property value.
- **General Fund balance:** the difference between assets and liabilities in the County's General Fund. Fund balance must be reported in five classifications, ranging from most to least restrictive: nonspendable, restricted, committed, assigned, and unassigned.
- **General Fund cash balance:** the amount of resources that are "liquid" (i.e. not held up in assets) and available for spending.
- **General Fund expenditures:** the general-purpose operating expenses that typically include County administration, public protection, public assistance, health and sanitation, recreation, capital outlay and debt principal and interest costs.
- **General Fund revenues:** the resources in the County's chief operating fund that come from property taxes, licenses and fees, fines and forfeitures, state and federal grants, and other charges. General Fund revenues are available for general purpose and discretionary spending by the County.
- **Net direct debt:** the County's total direct debt (including short-term and long-term obligations) less the total value of cash and cash equivalents.
- **Overall net debt:** the aggregation of all debt issued by agencies located within the County.
- **Total government available cash:** the amount of liquid resources available in the County's governmental funds, including the general fund, special revenue funds, capital projects funds and debt service fund.
- **Total governmental fund revenues:** the resources accounted for in the County's general, special revenue, capital projects and debt service funds, typically coming from taxes and intergovernmental aid.

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Section 1: Debt Issuance Transparency and Oversight

Background

The County's Administrative Capital Committee receives and evaluates requests for capital projects from County departments and centrally oversees the development of the 10-Year Capital Improvement Plan (CIP). The County Budget Director, who co-chairs this committee, proposes recommendations to the County Executive, who makes formal recommendations related to capital projects in the CIP and proposed project funding levels in the Recommended Budget. Appropriations for capital projects are approved annually by the Board of Supervisors, and projects that require debt financing are brought before the Board of Supervisors prior to issuance for approval of the bond sale.

Problem, Cause, and Adverse Effect

The Finance Agency is responsible for management of the County's debt and administration of the Board's Debt Policy, which seeks—among other goals—to minimize the cost of debt issuance. Although Administrative Capital Committee meetings reportedly include representatives of the Finance Agency, coordination between those developing the CIP & Recommended Budget and those administering County debt is informal, rendering the process for selecting and evaluating capital projects that require debt financing opaque. For instance, the criteria used to determine which projects are recommended for debt financing are not codified or formalized. Further, debt is expected to fund approximately $390 million or 50 percent of General Fund capital project costs over 10 years according to the FY 2020–21 10-Year CIP, yet neither the CIP document nor the Recommended Budget contain projections of debt service payments or their impact on future revenues. Though the Finance Agency reports that its Treasury Unit maintains an internal Debt Affordability Model to evaluate the County's debt affordability from a credit-rating perspective, the project team could not verify the practical implementation of this model. County officials consider the Board of Supervisors the ultimate decision-maker for the County in matters of debt issuance, but proposed debt issuances are not first heard and discussed in the County's Finance and Government Operations Committee (FGOC), and unlike many peer counties, Santa Clara County has not established a debt advisory or oversight committee to review potential financings and make appropriate recommendations to the Board of Supervisors.

Recommendations

The County Executive should formally establish requirements for the Administrative Capital Committee. The Board of Supervisors should amend the Rules of the Board to include a review of proposed debt issuances as a responsibility of the FGOC and consider establishing an independent oversight body. The Director of Finance should review, revise, and begin using the County's Debt Affordability Model to evaluate the long-term affordability and budgetary impacts of proposed issuances, and the Budget Director should include detailed information about proposed debt issuances and the strategic context of the debt portfolio in the Recommended Budget and the 10-Year Capital Improvement Plan.

Savings, Benefits, and Costs

Implementation of the recommendations will require one-time personnel costs and, in some cases, ongoing commitments of time and resources for members of committees. However, the recommendations will increase the transparency and oversight of the County's debt issuance process.

FINDING

Background

Appropriations for capital projects are approved annually by the Board of Supervisors following a recurring request process that is facilitated by the County's Administrative Capital Committee, which receives and evaluates requests for capital projects from County departments and centrally oversees the development of the 10-Year Capital Improvement Plan. The County Budget Director presents recommendations to the County Executive, who makes formal recommendations related to capital projects in the County's 10-Year Capital Improvement Plan and proposes project funding levels in the Recommended Budget.

Information from the 10-Year Capital Improvement Plan is presented in the County Executive's Recommended Budget in May, which outlines the recommended capital appropriations for the immediately upcoming fiscal year, and the Board approves the County's annual capital funding upon reviewing the Recommended Budget. Ultimately, projects that require debt issuances are brought before the Board of Supervisors prior to issuance for approval of the bond sale.

The Finance Agency is responsible for management of the County's debt and administration of the Board's Debt Policy. However, as discussed in more detail below, the debt financing decisions and analyses conducted throughout this process are not transparent or formalized.

Debt Financing Decisions, Analyses, and Processes are not Transparent or Formalized

Administrative Capital Committee and Debt Financing Criteria

The role, membership, and functions of the Administrative Capital Committee, which facilitates the prioritization of County capital projects—some of which will receive debt financing—are not formally established or codified in County administrative policies, nor stated in the County's 10-Year Capital Improvement Plan. According to County staff who regularly or occasionally attend Committee meetings, Committee membership is not fixed and meeting attendance fluctuates throughout the year. Further, the membership does not include the County Counsel, who may be able to provide input on the status of, and options for, lease agreements and other legal issues.

Based on information presented to the Administrative Capital Committee, the County Budget Director makes recommendations related to capital projects to the County Executive. The County Executive makes debt financing recommendations in the 10-Year Capital Improvement Plan to the Board of Supervisors based on input from these agencies.

However, there is no established criteria or process used by the County Executive, the Office of Budget and Analysis, and/or the Finance Agency to determine which projects receive debt financing, nor is there any criteria to evaluate the level of debt that would be required for a given capital project when it is being considered for funding. The County's Debt Management Policy (Board Policy 4.7.1) does not provide guidelines for assessing debt costs when determining whether to recommend a project for inclusion in the 10-Year Capital Improvement Plan. According to members of the Committee, the Committee does not make debt financing decisions or recommendations.

Overall, the County's process for selecting and evaluating capital projects that require debt financing is opaque. The criteria used to determine which projects are recommended for debt financing, and any criteria or analyses to evaluate the level of debt that would be required for a given capital project, are not codified or formalized, and the County's Debt Management Policy (Board Policy 4.7.1) does not provide guidelines or specific criteria for assessing debt costs when determining whether to include a debt-financed project in the County's 10-Year Capital Improvement Plan.

Debt Affordability Model

According to industry research, a:

> *[...] reliable assessment of how much a government can afford to pay in debt service, as well as how much outstanding debt it can safely carry should be a starting point for government's debt policy because governments need to have a thorough understanding of debt affordability prior to making issuance decisions or forecasting future capital needs.*[6]

The County developed its Debt Affordability Model to help manage and monitor its debt issuances and avoid a fiscal crisis. Use of the Debt Affordability Model and other analyses to evaluate the impact of debt is codified in Board Policy 4.7.1.4, which states:

> *The County shall assess the impact of new debt issuance on the short-term and long-term affordability of all outstanding and planned debt issuance, including additional operating costs. Such analysis recognizes that the County has limited capacity for debt service in its budget, and that each newly issued financing will obligate the County to a series of payments until the bonds are repaid. Tools include, but are not limited to, the County's Debt Affordability Model which helps evaluate the impact of proposed debt on the operating budget as well as on the County's credit ratings. [Emphasis added.]*

However, according to staff at the County's Finance Agency and the Office of Budget and Analysis, the County only uses its Debt Affordability Model to evaluate the impact of proposed issuances on the County's credit ratings. The County has not used the Debt Affordability Model to evaluate the impact of proposed debt on the County's operating budget to evaluate the short-term and long-term affordability and budgetary impacts of County debt, which was one of the purposes for which the Debt Affordability Model was developed.. The County has issued $1.7 billion in bonds since the Model was developed in 2017, including the two issuances in 2021.

6 Kriz, Kenh A, and Qiushi Wang. "Handbook of Local Government Fiscal Health: Debt Capacity, Management, and Policy." Handbook of Local Government Fiscal Health, by Helisse Levine et al., Jones & Bartlett Learning, 2013.

Long-Term Planning

According to the California Debt Financing Guide issued by the California Debt and Investment Advisory Commission (CDIAC),[7] CDIAC No. 19.05, issued June 2021, debt-issuing agencies should "adopt a long-term financial plan to align financial capacities with the long-term service objectives." The elements of the long-term financial plan recommended in the California Debt Financing Guide include: "a projection of [the agency's] financial condition at the end of the period; projections of revenues and expenditures; proposed changes in programming or capital financing; an assessment of economic conditions, service objectives, and financial challenges; and financial policies regarding liquidity, debt capacity, or reserve requirements."

Generally speaking, neither the County's 10-Year Capital Improvement Plans nor its Recommended Budget describe the County's debt financing strategy or provide the recommended long-term perspective on the County's debt portfolio to the level of detail recommended in the California Debt Financing Guide.[8] While the County's Recommended Budgets do include projections of debt service payments for currently outstanding debt, these projections are limited to existing debt obligations; the Recommended Budget notes that additional debt may be issued as a result of capital projects, and directs the reader to the 10-Year Capital Improvement Plan for more information on future debt issuances.

We reviewed recent 10-Year Capital Improvement Plans from FY 2019–20, FY 2020–21, and FY 2021–22, and found that the individual projects that were identified in the Plan as debt-financed did not contain any details about the planned debt, such as estimated debt service, other than the total amount. The Plans also did not provide a strategic, long-term view of the County's overall debt portfolio, despite the 10-Year Capital Improvement Plan's function as the County's long-term planning document for capital and the significant funding source that debt financing provides. For example, in the County's most recent FY 2021–22 through 2030–31 10-Year Capital Improvement Plan, nearly 50 percent of the funding sources for General Fund projects in FY 2021–22 ($390 million out of $788 million) were proposed for debt financing. However, the 10-Year Capital Improvement Plan did not contextualize the proposed $390 million in debt financing compared to the County's existing debt burden and did not provide details about the anticipated structure or financing terms of the $390 million debt issuance.

Our office published an audit of the Capital Programs Division in June 2020, which included a recommendation that the County Budget Director:

> *Oversee all aspects of infrastructure asset management on a Countywide level. This oversight should include review of capital funding needs; analyzing debt capacity and developing capital financing strategies; and evaluating the status of ongoing projects and the nature of reappropriated surpluses, along with recommending re-allocation of these funds, if necessary. The County Budget Director should also create a capital finance*

7 The California Debt and Investment Advisory Commission serves as the state's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt.

8 The Finance Agency presents an Annual Debt and Swap Report to the Board of Supervisors, as required in Board Policy 4.7.1.2(b). However, while this report describes debt-related activities conducted during the report year, it does not provide a forward-looking long-term financing strategy or contextualize the County's long-term debt service obligations.

> *plan model for the County's Capital Improvement Program Plan (CIP) that includes debt service payments and revenue sources for the proposed CIP. The Budget Director should document and present the major assumptions of this model during annual budget hearings. At minimum, the capital finance plan model and associated documentation should be prioritized and completed by the outset of Fiscal Year 2021–22. At that time, the County Budget Director should report to the Board the degree to which other oversight components of our recommendations were implemented, the barriers to implementation, if any, and a projection for when these items will be fully implemented. (Priority 1)*

Although the County Budget Director agreed with this recommendation, to date, it has not been implemented.

Debt Financing Options and Details Not Presented to the Board of Supervisors

County Administration does not provide sufficient information to the Board of Supervisors to enable the Board to make fully informed decisions regarding debt issuances. Board Policy 4.7.1.1 states that when issuing debt, the County shall ensure that it "maintains accountability for the fiscal health of the County, including management and transparency of the County's financing programs." In addition, Board Policy 4.7.1.4(C) designates the Director of Finance as the individual responsible for "determining the appropriate structure for the debt financing considering factors including, but not limited to, the inter-generational benefit of the financing and current market conditions." In the context of these Board policies, County Administration presents its recommendations related to proposed debt issuances to the Board of Supervisors, and County officials consider the Board the ultimate decision-maker for the County in matters of debt issuance. However, County Administration does not proactively provide context or additional information regarding its debt-related recommendations to the Board to enable the Board to make fully informed decisions regarding debt issuances.

According to the California Debt Financing Guide issued by CDIAC[9] (CDIAC No. 19.05, issued June 2021):

> *Elected and appointed public officials are subject to securities law and are held to a fiduciary standard when acting in an official capacity. Both of these requirements impose a standard of care and expertise that can only be achieved through a deliberate, ongoing effort to analyze, understand, and evaluate alternative courses of action. [...] Before issuing debt, therefore, elected and appointed officials should understand the agency's financing needs, its alternative financing strategies, the implication of each on the agency's mission and its financial well-being, and the agency's capacity to meet its long-term financial and administrative responsibilities if debt is the chosen alternative. (Page i-21).*

The Board of Supervisors is responsible for understanding a given proposed debt issuance, the terms of the issuance, and the long-term impact of the issuance on the County's finances. The structure and terms of a particular debt issuance determine the total overall cost of a given issuance to the County. However, decisions made

9 The California Debt and Investment Advisory Commission serves as the state's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt.

by County Administration regarding recommendations to the Board of Supervisors on: (a) whether to issue debt for a project or make purchases with existing funds, and (b) the structure and type of debt to be issued for a project, are not publicly communicated to the Board of Supervisors or documented in supporting legislative files, despite the fiscal implications for the County. County Administration does not publicly describe the rationale for issuing debt for a particular project as opposed to making a purchase with existing funds in the 10-Year Capital Improvement Plan, nor does the Board receive information about different types of debt and financing options when a proposed issuance comes before the Board for approval. In 2016, information on the costs of general obligation bonds compared to lease revenue bonds was provided to the Board of Supervisors in an Off-Agenda Report; however, this information was only provided in response to a request from one of the members of the Board of Supervisors and is not regularly included in information presented to the Board.

In addition, resolutions approving the issuance of debt are not heard by the Finance and Government Operations Committee prior to consideration by the full Board of Supervisors. As stated in Chapter VII, Section 33 of the Rules of the Board of Supervisors, the purpose of the Finance and Government Operations Committee (one of the five major policy committees of the Board) is "to evaluate and make recommendations to the Board of Supervisors on all items of significant importance, both fiscal and policy, to the County of Santa Clara," including "(b) issues which would have an impact of $100,000 or more on the budget of the County, and (c) issues which, in the opinion of the County Executive or a member of the Board, may be of a controversial nature and/or would benefit from a preliminary review by committee." The lack of Finance and Government Operations Committee hearings on proposed debt issuances limits the ability of the Board of Supervisors to discuss and review proposed debt issuances in detail.

Finally, as noted above by CDIAC, members of the Board of Supervisors as elected public officials are responsible for understanding the County's financing needs, its alternative financing strategies, the implication of each on the County's mission and financial well-being, and the County's capacity to meet its long-term financial and administrative responsibilities. However, County Administration does not formally provide incoming newly-elected members of the Board of Supervisors with an orientation or background materials about the County's existing debt portfolio, the Supervisors' roles and responsibilities in the debt issuance process, and the County's process for issuing debt.[10] Given that incoming supervisors may have varying levels of familiarity with public-sector debt and its process of issuance, the absence of a formal training curriculum for new supervisors creates a risk that not all members of the Board make decisions with adequate levels of information and expertise.

County Administration states that in its view, the Board of Supervisors is responsible for making the final decisions related to the County's debt financing. However, our review of the materials that are presented to the Board indicate the need for more detail and consistency in the information provided. The full Board of Supervisors hearings (and corresponding staff packets) are the only opportunity to publicly review and discuss the Administration's recommendations to issue debt because proposed

10 Educating County elected officials about the bond market is included in the scope of work for the County's contracted municipal finance advisor.

debt issuances are not first brought to the Finance and Government Operations Committee for review and discussion. Given the size of the County's debt profile and the complexity of public financing, the Board needs more robust background to make the best decisions on behalf of the County and taxpayers.

Practices of Other Counties

As described in the Methodology section of this report starting on page 15, we administered a survey regarding the fiscal oversight and reporting mechanisms used to communicate debt issuance decisions to governing bodies and external stakeholders of peer counties in California. Nine out of the 15 identified peer counties responded in whole or in part to the survey. Six of the nine responding counties (67 percent) have established some form of oversight bodies or advisory boards to review potential financings and make appropriate recommendations to the Board of Supervisors:

- Contra Costa County's debt oversight body is its **Debt Affordability Advisory Committee**; the body's membership includes the Treasurer-Tax Collector, the Auditor-Controller, the County Finance Director, and the Conservation and Development Director.
    - The Debt Affordability Advisory Committee reviews and approves recommendations to issue debt, prior to the issuance being scheduled for a public hearing and before Board of Supervisors approval. The Committee is also tasked with issuing an annual debt report that defines debt capacity and recommends how much new debt can be authorized by the County without overburdening itself with debt service payments.
- Fresno County's debt oversight body is its **Debt Advisory Committee**; the body's membership includes two members of the Board of Supervisors, the County Administrative Officer, at least one representative from the Auditor-Controller/Treasurer-Tax Collector, and County Counsel.
    - Financing proposals are submitted to the Debt Advisory Committee for review and fiscal impacts are addressed in the Board agenda items presented at the Debt Advisory Committee. The Debt Advisory Committee makes its recommendation or no recommendation to the Board of Supervisors; the Board has the final authority for taking actions on the financing proposals.
- Orange County's debt oversight body is its **Public Financing Advisory Committee**; the body's membership includes five public members appointed by the Board of Supervisors (voting), the County Executive Officer (non-voting), the Auditor-Controller (non-voting), and the Treasurer-Tax Collector (non-voting).
    - All bond financings go to the Public Finance Advisory Committee for recommendation prior to submission to the Board of Supervisors agenda for approval.
- San Diego County's debt oversight body is its **Debt Advisory Committee**; the body's membership includes the Assistant Chief Administrative Officer, the Deputy Chief Administrative Officer/Chief Financial Officer, the Auditor-Controller, and the Treasurer-Tax Collector.

    - Upon determination by the Debt Advisory Committee that a proposed project meets all criteria, the Debt Advisory Committee prepares a Board letter for the Board of Supervisors with reasons for approving the financing.

    - San Diego County's investor relations website contains current information on the County's outstanding debt portfolio as well as details specific to each bond issue outstanding. Budget document includes robust discussion of debt management policies and obligations, including bond ratio tables and statistics. [Auditors' note.]

- San Francisco County's debt oversight bodies are its **Capital Planning Committee** and its **Citizens' General Obligation Bond Oversight Committee**, as well as an informal advisory group of its debt-issuing entities. The Capital Planning Committee is chaired by the City Administrator and includes the President of the Board of Supervisors, the Mayor's Budget Director, the Controller, the City Planning Director, the Director of Public Works, the Airport Director, the Executive Director of the Municipal Transportation Agency, the General Manager of the Public Utilities System, the General Manager of the Recreation and Parks Department, and the Executive Director of the Port of San Francisco. The Citizens' General Obligation Bond Oversight Committee has nine members who are appointed as follows: three members by the Mayor, three members by the Board of Supervisors, two members by the Controller, and one member by the Civil Grand Jury.

    - At the outset of every bond issuance process, debt staff meet with capital project managers to discuss expenditure plans in detail, evaluate reasonableness of assumptions, and identify challenges to timely spending of bond proceeds. Each proposed financing is reviewed by the Capital Planning Committee, the Office of Public Finance, and the Board's Independent Budget Analyst. Each department requesting sale of voter-approved General Obligation bonds must file a Bond Accountability Report 60 days prior to the approval by the Board of Supervisors of the sale of the bonds, and within 60 days after the date of all such appropriated bond proceeds have been expended.

- Stanislaus County's debt oversight body is its **Debt Advisory Committee**; the body's membership includes the County's Chief Executive Officer, Treasurer-Tax Collector, Auditor-Controller, County Counsel, Planning Director, Public Works Director, and Chief Financial Officer.

    - The Debt Advisory Committee, with input from the Treasurer-Tax Collector, reviews project proposals and cost estimates prepared by project proposers and external advisors. The financing proposal is then put on the agenda for Board approval.

The three responding jurisdictions that do not have a debt oversight body are Los Angeles County, San Joaquin County and San Mateo County. However, in San Mateo County, project cost estimates are reviewed by the San Mateo County Joint Powers Authority (comprised of the County Manager's Office, the Chief Financial Officer, and County Counsel) and fiscal impacts are communicated through the Budget or Memos dependent on need.

As detailed above, Contra Costa, Fresno, Orange, San Diego, San Francisco, and Stanislaus counties have established some form of formal debt advisory or oversight committee to review potential financings and make appropriate recommendations. Committee membership generally includes the county's chief financial officer, auditor and/or controller, treasurer-tax collector, and a county administrative officer and/or executive. Fresno County includes members of the Board of Supervisors, and Orange County includes members of the public. In contrast, Santa Clara County's Administrative Capital Committee focuses on capital projects generally, does not make recommendations regarding debt financing structure or timing, and does not review proposed debt issuances or make recommendations to the Board of Supervisors.

To avoid the silo-ing of information, CDIAC recommends the use of inter-agency working groups similar to the advisory committees used by many of Santa Clara County's peers. CDIAC, in its California Debt Financing Guide, recommends that:

> *particularly when making debt financing decisions, public agencies must develop an organizational approach that intends to break down siloed thinking. Forming work groups composed of multidisciplinary teams to develop goals, gather information, and identify alternatives is one way to do this. When making debt financing decisions, the agency should build that team with representatives from legal, financial, and facilities operations and engineering units.*

CONCLUSION

County Administration has not closely followed the requirements set out in the County's Debt Management Policy (Board Policy 4.7.1) related to transparency and the use of analytical tools to evaluate the impact of proposed debt. The County's capital planning process is insufficiently documented in County policies, and there is little information available to the public or the Board about: (a) the decisions made during the capital planning and debt planning process, (b) the structure of proposed debt in the County's annual capital planning process, and (c) the long-term impacts of proposed debt issuances on the County's debt portfolio and finances.

Although County Administration states that the Board is the ultimate decision-maker regarding debt issuances, the information that Administration publicly provides to the Board about these debt issuances is inadequate and limits the Board's ability to make fully informed decisions. No committee, either of the Board of Supervisors (like the Finance and Government Operations Committee) or a separately-established committee, reviews proposed debt issuances and financing structures to make recommendations to the Board.

RECOMMENDATIONS

The County Executive should:

1.1 Formally establish membership of the Administrative Capital Committee (which should include the County Counsel) and formally define the function of the Committee. (Priority 3)

The County Director of Finance should:

1.2 Establish a formal orientation curriculum for all newly-elected Board members with information related to the County's existing debt portfolio, the Supervisors' roles and responsibilities in the debt issuance process, and the County's process for issuing debt. (Priority 2)

1.3 Review the County's Debt Affordability Model and determine which, if any, changes need to be made in order for it to be used to evaluate the long-term affordability and budgetary impacts of proposed debt issuances. Once any needed changes have been made, immediately begin fully using the Debt Affordability Model to evaluate the long-term affordability and budgetary impacts of proposed issuances, and include the results in materials presented to the Board of Supervisors. (Priority 2)

1.4 Include the findings from the Debt Affordability Model analysis and other cost/benefit analyses in legislative files and other materials presented the Finance and Government Operations Committee and/or the full Board of Supervisors related to proposed debt issuances. Debt affordability metrics should include, but not be limited to: total governmental funds debt service; debt par amount outstanding; estimated par amount and new debt service for proposed bond issuance; estimated total par amount and annual debt service including new debt issuance; direct debt compared to assessed valuation; debt per capita; and, total governmental funds debt service compared to expenditures. (Priority 2)

The County Budget Director should:

1.5 Include more detailed information and affordability metrics about proposed debt issuances and provide long-term strategic context on the County's overall debt portfolio in either the County's 10-Year Capital Improvement Plan or its Recommended Budget, and provide long-term strategic context on the County's overall debt portfolio. Debt affordability metrics should include, but not be limited to: total governmental funds debt service; debt par amount outstanding; estimated par amount and new debt service for proposed bond issuance; estimated total par amount and annual debt service including new debt issuance; direct debt compared to assessed valuation; debt per capita; and, total governmental funds debt service compared to revenues. (Priority 2)

The Board of Supervisors should:

1.6 Amend the Rules of the Board of Supervisors to include a review of proposed debt issuances as a matter under the responsibility of the Finance and Government Operations Committee, so that all proposed debt issuances are heard first in the Finance and Government Operations Committee before being heard by the full Board of Supervisors. (Priority 2)

1.7 Consider establishing a Debt Affordability Advisory Committee, with formal membership, to review and make recommendations to the Finance and Government Operations Committee related to the County's debt issuances. (Priority 2)

1.8 Modify Board Policy 4.7.1 (Debt Management Policy) to require the Finance Agency to conduct an annual review of the County's Debt Affordability Model. (Priority 3)

SAVINGS, BENEFITS, AND COSTS

Formally establishing the membership and function of the Administrative Capital Committee would require one-time use of staff resources but generate no ongoing costs for the County. Formalizing the Administrative Capital Committee through the Office of the County Executive will allow the Committee to function as an administrative committee of the County, which will codify the membership and function of the Administrative Capital Committee without requiring the Committee to adhere to the requirements of the Brown Act. Amending the Rules of the Board of Supervisors to include a review of proposed debt issuances as a matter under the responsibility of the Finance and Government Operations Committee would increase the scope and workload of that committee and require an ongoing time commitment for members of that committee and supporting staff. Establishing a Debt Affordability Advisory Committee or similar oversight body would require an ongoing commitment of time and resources from the members of that body as well as staff to ensure compliance with the Brown Act. However, reviewing proposed debt issuances at the Finance and Government Operations Committee and/or another established oversight committee would increase the transparency of the County's debt issuances and provide the Board of Supervisors with additional opportunities to review, discuss, and evaluate the Administration's proposed debt issuances. Greater transparency and increased public review will decrease the risk of the County issuing injudicious or unnecessary debt.

Reviewing and revising the Debt Affordability Model will require one-time personnel costs from the Finance Agency and from the County's municipal finance advisor, which is already included in the municipal finance advisor's scope of work. However, full and comprehensive usage of the Debt Affordability Model will provide the County with a quantitative evaluation of the impact of proposed debt on the operating budget. Finally, inclusion of more debt-related information and strategic context in either the County's Recommended Budget or the 10-Year Capital Improvement Plan will require an annual commitment from the Office of Budget and Analysis to prepare the information, but will benefit the County by increasing transparency and appropriately contextualizing the County's proposed debt alongside its existing portfolio.

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Section 2: Debt Management Policy

Background
Santa Clara County's Debt Management Policy (Board Policy 4.7.1) was adopted in September 2003 and most recently amended in September 2017. The goal of the Debt Management Policy is to establish debt management objectives and the overall parameters for issuing and administering the County's debt.

Problem, Cause, and Adverse Effect
The County's Debt Management Policy does not contain all the elements recommended by the Government Finance Officers Association (GFOA) as best practice for debt management policies, and the Debt Management Policy does not establish any practical limit to the amount of debt the County may incur. As a result, there is no prescriptive limit to the amount of debt Santa Clara County may incur: while the State establishes a legal limit of debt for the County, this limit is too high to function practically as a debt limitation. Further, the legal debt limit also does not apply to lease revenue bonds, which are a major source of the County's debt financing. When compared to a group of peer California counties, Santa Clara County has fewer controls on debt levels, as well as a higher debt burden across a variety of metrics.

Without detailed and thorough debt management policies as recommended by GFOA, the County is at an elevated risk of injudicious or unnecessary use of debt and poorly structured debt or repayment schedules, which could result in regulator penalties, credit rating agency downgrades and resulting borrowing cost increases, and a lack of investor and taxpayer confidence.

Recommendations
Board Policy 4.7.1.2(B)(1) states that the Finance Agency is responsible for an annual review the County's Debt Management Policy. Accordingly, the County Director of Finance should review and propose revisions for consideration by the Board of Supervisors to the County's Debt Management Policy to incorporate all elements recommended by GFOA as best practice for debt management policies. These elements should include, but not be limited to: debt limits, debt structuring practices, debt issuance practices, debt management practices, and the County's use of derivatives.

Savings, Benefits, and Costs
A revision to the County's Debt Management Policy will require one-time personnel costs for Finance Agency staff time, as well as Board of Supervisors time to review and approve the proposed changes. However, given that this is an existing function within the Finance Agency, these changes would not require additional position authority. More detailed and thorough debt management policies will benefit the County by reducing the risk of injudicious or unnecessary use of debt, poorly structured debt or repayment schedules, or a failure to meet disclosure or tax obligations. Improved policies will also aid policymakers in evaluating proposed debt issuances to minimize County costs and understanding the County's debt portfolio performance overall.

FINDING

Background

Santa Clara County's Debt Management Policy (Board Policy 4.7.1) was adopted in September 2003 and most recently amended in September 2017. The goal of the Debt Management Policy is to establish the overall parameters for issuing and administering the County's debt and the County's debt management objectives, which are to: minimize debt service and issuance costs; maintain access to cost-effective borrowing; achieve the highest practical credit rating; achieve full and timely repayment of debt; maintain full and complete financial disclosure and reporting; ensure financial controls are in place with respect to proceeds of debt; and ensure compliance with applicable state and federal laws. Note that the County has a separate "Debt Internal Control Policy" which focuses on post-issuance debt management, as discussed in Section 4, starting on page 57 of this report.
The Finance Agency is the agency responsible for annually reviewing the Debt Management Policy, and any modifications to the policy are to be presented to the Finance and Government Operations Committee with ultimate approval from the Board of Supervisors.

The County's Debt Management Policy does not contain all the elements recommended by the Government Finance Officers Association (GFOA) as best practice for debt management policies, and the Debt Management Policy does not establish any practical limit to the amount of debt the County may incur. Benchmarking results reveal that compared to peer California counties, Santa Clara County has a higher debt burden as represented by either principal outstanding or debt service payments. In addition, Santa Clara County's Debt Management Policy is significantly less detailed than the policies identified by the California Debt and Investment Advisory Commission as "exemplary" debt management policies. Approximately two-thirds of identified peer California counties have established quantitative policy limits or prescriptive ranges for debt outstanding and/or debt service, in accordance with GFOA recommendations; however, Santa Clara County's Debt Management Policy does not establish any such limits.

County's Debt Management Policy Does Not Conform to Best Practices

The debt management best practices developed by the GFOA include multiple recommendations for governments' adopted debt management policies. As shown in Figure 2.1 on the following page, the County's current Debt Management Policy does not contain many of the elements recommended by the GFOA.

Figure 2.1: *Comparison of Santa Clara County Debt Management Policy to GFOA Recommendation*

GFOA Recommendation [emphasis added]	Current Santa Clara County Debt Management Policy
Debt Limits "The Policy should consider setting specific limits or acceptable ranges for each type of debt. Limits generally are set for legal, public policy, and financial restrictions and planning considerations."	Board Policy 4.7.1.4 states only: "The County will keep outstanding debt within the practical limits of the County's debt rating and any applicable law."
Debt Structuring Practices "The Policy should include specific guidelines regarding the debt structuring practices for each type of bond, including: maximum term; average maturity; debt service pattern; use of optional redemption features that reflect market conditions and/or needs of the government; use of variable or fixed-rate debt, credit/liquidity enhancements, derivatives, short-term debt, and limitations as to when, and to what extent, each can be used; and other structuring practices."	Board Policy 4.7.1.2 contains a list of debt types that may be issued, but does not contain any of the GFOA recommended information. Board Policy 4.7.1.4 states "The Director of Finance shall be responsible for determining the appropriate structure for the debt financing considering factors including, but not limited to, the inter-generational benefit of the financing and current market conditions." This section contains some guidelines and "considerations" for debt repayment, variable-rate debt, and tax structure, but not to the level of detail recommended by GFOA.
Debt Management Practices The Policy should provide guidance for ongoing administrative activities including: • Investment of bond proceeds, • Primary market disclosure practices and procedures, including annual certifications as required, • Continuing disclosure procedures; including those related to ensure compliance with any continuing disclosure undertaking (CDA), • Arbitrage rebate monitoring and filing, • Monitoring use of tax-exempt bond financed facilities for private use, • Federal and state law compliance practices, and • Ongoing market and investor relations efforts	Section 4.7.1.5 "Debt Administration" contains some of these elements, but not in significant detail. The County has separate Continuing Disclosure Procedures that define the Disclosure Practices Working Group and responsibilities. The County has a separate "Debt Internal Control Policy" that describes post-issuance debt management practices.
Use of Derivatives The Debt Management Policy should clearly state whether the entity can or should use derivatives. If the policy allows for the use of derivatives, a separate and comprehensive derivatives policy should be developed.	Board Policy 4.7.1.2(A)(2) states: "While the County currently has one interest rate swap in its outstanding debt portfolio, no further issuance of derivatives is contemplated." This language does not "clearly state whether or not the county can use derivatives." However, the County does have a separately developed Interest Rate Swap Policy (Addendum to Section 4.7).

Source: GFOA Best Practices – Debt Management Policy; Santa Clara County Debt Management Policy (Board Policy 4.7.1); County of Santa Clara Continuing Disclosure Procedures (Feb. 28, 2019).

No Practical Limit to County Indebtedness

As shown in Figure 2.1 on page 39, while the GFOA recommends that a debt management policy include "specific limits or acceptable ranges for each type of debt," the County's policy states only that "the County will keep outstanding debt within the practical limits of the County's debt rating and any applicable law." Because the County's policy does not include any specific limit or range of indebtedness, the only limit that controls the County's debt level is the statewide limit of 1.25 percent of total assessed valuation, as established in California Government Code Section 29909. As shown in Figure 2.2 below, given the County's high overall assessed valuation, its legal debt limit has been significantly higher (ranging from $3.1 billion to $5.6 billion) than its outstanding general bonded debt over the last 10 years. As of June 30, 2020, the County's legal debt limit of $6.4 billion was $5.6 billion higher than its $881 million in general bonded debt.

Figure 2.2: *Santa Clara County Legal Debt Margin, FY 2010–11 to FY 2019–20*

Fiscal Year	Total Assessed Valuation ($ thousands) [a]	Legal Debt Limit ($ thousands)	General Bonded Debt ($ thousands) [b]	Legal Debt Margin ($ thousands) [c]
FY 2010–11	$296,276,139	$3,703,452	$334,900	$3,368,552
FY 2011–12	298,909,572	3,736,370	316,800	3,419,570
FY 2012–13	308,606,339	3,857,579	805,800	3,051,799
FY 2013–14	334,477,346	4,180,967	804,700	3,376,267
FY 2014–15	357,105,923	4,463,824	799,180	3,616,297
FY 2015–16	398,419,971	4,980,250	792,585	4,141,100
FY 2016–17	431,308,057	5,391,351	784,845	4,561,719
FY 2017–18	449,772,839	5,622,160	1,012,400	4,539,531
FY 2018–19	482,861,280	6,035,766	947,220	5,088,546
FY 2019–20	515,690,038	6,446,125	881,455	5,564,670

Source: FY 2019–20 Santa Clara County Consolidated Annual Financial Report (page 232).

Notes:
a: Total assessed valuation includes exempt property.
b: Outstanding par amount of general obligation bonds (excludes bond premium).
c: The legal debt margin is the legal debt limit less all general bonded debt.

In addition, the County's legal debt limit that is specified in California Government Code Section 29909 applies only to general obligation bond indebtedness. However, as discussed in more detail in Section 3, starting on page 47, *Reliance on Lease Revenue Bonds*, the County regularly issues lease revenue bonds: on June 30, 2020, the County had $908 million in outstanding lease revenue bond balance, compared to $881 million in outstanding general obligation bond balance. As stated earlier, the County's debt management policy does not contain many of the elements recommended by the GFOA as best practice for debt management policies, one of which is to "consider setting <u>specific limits or acceptable ranges</u> for <u>each type</u> <u>of debt</u>" [emphasis added].

Santa Clara County has not set any specific limits or ranges for different debt types, which means it has no practical, effective debt limit. Reliance on the State-established legal limit does not put a real constraint on the County's borrowing, and it does not give policymakers context to understand how debt affects the County's finances in the short or long term. Although the County remains well within its legal borrowing limit, when comparing Santa Clara County's performance on debt and financial performance metrics such as net direct debt to assessed valuation, net direct debt per capita, or net direct debt as a percentage of total governmental fund revenues, Santa Clara County under performs compared to its peer counties, as discussed in more detail in the following subsection.

Debt Performance Metrics Compared to Peer Counties

Our project team used the benchmarking approach recommended by the GFOA, which is to compare the County's debt levels and credit performance to that of other counties in California. As noted in the Methodology section, starting on page 15 of this report, when benchmarking debt statistics, the choice of comparable governments must be done with caution because no two communities are identical. To ensure our comparisons were as appropriate as possible, we evaluated and compared the County to peer counties in California with populations greater than 500,000 that satisfied one or more of the following criteria: (1) the county is located in the Bay Area; (2) the county is among the 10 most populous in the state; and (3) the county operates a hospital. The unique list of 15 counties (excluding Santa Clara County) that met one or more of these parameters along with the three benchmarking groups they correspond to is shown in Figure M.1 on page 16 of the Methodology section of this report.

Financial ratios serve as a proxy for affordability and provide a convenient way to compare the County's debt performance against other borrowers. The benchmarking survey presented in Figure 2.3 on page 43 displays quantitative measures commonly used by rating agencies to evaluate the creditworthiness of local governments and compares the County's results to those of its peer California counties. Our benchmarking analysis and methodology, including the identification of the peer counties, are described in more detail in the Methodology section of this report starting on page 15.

Figure 2.3 on page 43 summarizes the County's credit performance across key metrics to the medians of all 15 selected peer California counties, as well as the three benchmarking peer subgroups used by our project team (see Figure M.1 on page 16 of the Methodology section) to make the comparison more relevant (Bay Area counties, the State's most populous counties, and counties with hospitals). As shown in Figure 2.3 on page 43, Santa Clara County consistently under performs on nearly all finance and debt metrics when compared to the medians of identified peer counties in California:

On all six debt-related measures (measures 1-6 in Figure 2.3 on page 43), the County's values underperformed compared to medians of all California peer counties and across all benchmarking groups.

Debt burden, as represented by either principal outstanding or debt service payments, appears uniformly higher for Santa Clara County when compared to the medians of peer groups in Figure 2.3 on page 43. As noted above, the County's current Debt Management Policy contains no meaningful cap or limit on the amount of debt the County may incur, and the results of our benchmarking analysis indicate that the County has a comparatively high level of debt.

Santa Clara County has a higher assessed valuation per capita, a larger population, and a higher net assessed property value than the median of the 15 peer California counties. Given the County's high valuation and, as noted by Moody's, its "exceptionally large and diverse tax base" and the "above-average wealth indicators of County residents," the County's performance on the finance-related measures (measures 7–10 in Figure 2.3 on page 43) varied more when compared to the medians of its peers. However, our results do show that the County under performs compared to peers on its General Fund balance, available General Fund balance, and General Fund cash balance as a percentage of revenues.

Comparison to Other Counties' Practices

In addition to the quantitative metrics discussed above, we also reviewed the debt policies of the 15 peer California jurisdictions to identify specific restrictions on debt issuance or capacity and any fiscal indicators for measuring debt affordability. Of the policies reviewed, only five counties (33 percent) did **not** have established parameters for what levels of debt and debt service payments are appropriate for the agency. The remaining 10 counties (67 percent) have quantitative policy limits or prescriptive ranges for debt outstanding and/or debt service as shown in Figure 2.4 on page 44.

Figure 2.3: *Benchmarking Santa Clara County's Fiscal Indicators to Peer Counties in California for FY 2019–20*

	County Value (FY 2019-20)	Median of All Peer Counties	I. Median of Bay Area Counties	II. Median of Most Populous Counties	III. Median of Counties with Hospitals
Debt Measures					
1. Net direct debt to assessed valuation					
Lower value better	0.50%	0.27%	0.33%	0.26%	0.26%
2. Net direct debt per capita					
Lower value better	$1,301	$351	$773	$327	$365
3. Net direct debt as % of total governmental fund revenues					
Lower value better	62%	19%	36%	17%	19%
4. Total government available cash as % of debt service					
Higher value better	1511%	1910%	2030%	1885%	2269%
5. Annual debt service as % of General Fund revenues					
Lower value better	5.2%	4.0%	4.6%	4.4%	3.9%
6. Annual debt service as % of expenditures					
Lower value better	4.8%	3.3%	3.9%	3.3%	3.3%
Finance Measures					
7. Available General Fund balance as % of revenues					
Higher value better	24%	32%	50%	27%	34%
8. General Fund cash balance as % of revenues					
Higher value better	42%	43%	68%	35%	45%
9. General Fund balance as % of revenues					
Higher value better	31%	42%	60%	36%	42%
10. Total government available cash as % of expenditures					
Higher value better	72%	64%	94%	49%	69%

Source: Medians of peer California counties are calculated using information from the respective FY 2019–20 Comprehensive Annual Financial Report (CAFR) of the 15 counties (excluding Santa Clara) listed in the Methodology section.

Figure 2.4: *Fiscal Constraints in Debt Policies of Peer California Counties*

County	Debt Constraint
Alameda	Annual aggregate Net Debt Service obligations of the County shall not exceed 20% of total discretionary General Fund revenues
Contra Costa	Multiple ratios benchmarked against cohort of urban counties in California 20-year bond repayment term
Fresno	Considers debt service as percentage of General Fund expenditures for current and four most recent fiscal years Requires all new debt proposals to include repayment schedules and alternative scenarios
Kern	None Identified
Los Angeles	None Identified
Orange	Annual principal and interest payments on County General Fund debt obligations will not exceed 4% of General Fund revenue
Riverside	Aggregate debt service, excluding self-supporting debt, should not exceed 7% of General Fund discretionary revenue and will not exceed 10% without the Board of Supervisors' approval
Sacramento	None Identified
San Bernardino	None Identified
San Diego	Total annual principal and interest payments on all long-term obligations of the General Fund will not exceed 5% of General Fund revenue Considers debt outstanding and debt service ratios in presentations to County management
San Francisco	Per City Charter, outstanding GO debt shall not exceed 3% of assessed value of taxable property within City boundaries[11] City policy is to maintain the percentage of General Fund spent on General Fund-secured debt at or below 3.25% of General Fund discretionary revenues
San Joaquin	Net Direct Debt as a percentage of operating revenues <30% Total Governmental Funds Debt Service/Total Governmental Expenditures <8%
San Mateo	Annual debt service limit applicable to non-voter approved debt that is the obligation of the County shall not exceed 4% of the average annual County budget for the current and the preceding four fiscal years
Stanislaus	None Identified
Ventura	The total County debt outstanding, including Pension Obligation Bonds, shall not be greater than 1% of the total assessed value of property located within the County The total County debt service, including Pension Obligation Bonds, shall not be greater than 6% of the total General Fund expenditures

Source: Statements obtained from the Debt Management Policy of each respective county.

11 According to San Francisco officials, the State's 1.25% threshold is not applicable as San Francisco is both a City and a County.

Unlike Santa Clara County, most peer California counties from our comparison groups have established some quantitative policy limits or prescriptive ranges for debt outstanding and/or debt service, as recommended by both GFOA and CDIAC, the California Debt and Investment Advisory Commission (CDIAC), which was created to serve as the state's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt.

In a 2014 review of the contents of 84 individual debt management policies of cities, counties, and school districts in California, CDIAC identified what it considered to be three "exemplary" debt management policies that conform to the spirit of GFOA's best practices: the debt management policies of the City of Fresno, Butte County, and the Los Angeles Unified School District. The full debt management policy of Butte County, which is 41 pages long compared to the County's eight pages, includes specific debt ratio limits for the County (net direct debt/property valuations, net direct debt/operating revenues, and total governmental funds direct debt service/total governmental expenditures). Butte County's policy also includes, as an appendix, the forms and analysis requirements of proposed financings. The full debt management policy of Butte County is included as Attachment D on page 93 to this report for review and reference.

In this same review of California agencies' debt management policies, CDIAC writes: "In the absence of policies, issuers may fail to control the type, structure, and maturity of debt being issued. They may enter into service contracts that are not well understood and potentially harmful. And they may fail to meet federal disclosure and tax compliance obligations."

CONCLUSION

There are no practical constraints on the amount of debt Santa Clara County may incur. While the California Government Code establishes a legal limit of debt for the County, this limit is too high to function practically as a debt limitation. The legal debt limit also does not apply to lease revenue bonds, which are a major source of the County's debt financing. Because the County has not established any other debt limits or ranges, it has no practical, effective debt limit. When compared to a group of peer California counties, Santa Clara County has fewer controls on debt levels, as well as a higher debt burden across a variety of metrics.

Without detailed and thorough debt management policies, the County is at an elevated risk of injudicious or unnecessary use of debt and poorly structured debt or repayment schedules, which could result in regulator penalties, credit rating agency downgrades and resulting borrowing cost increases, and a lack of investor and taxpayer confidence. By developing stronger policies, the County will be more likely to identify risks associated with managing its debt portfolio, develop strategies to mitigate those risks, and will be better positioned to plan for the long-term management of its debt portfolio.

The Finance Agency is the agency responsible for annually reviewing the Debt Management Policy. The County's existing Debt Management Policy should be revised to incorporate the recommended GFOA elements, so that the Debt Management Policy fulfills its goal of establishing the overall parameters for issuing and administering the County's debt so that the County can accomplish its debt management objectives.

RECOMMENDATIONS

The County Director of Finance should:

2.1 Review and propose revisions for consideration by the Board of Supervisors to Board Policy 4.7.1, the County's Debt Management Policy, to incorporate all elements recommended by GFOA as best practice for debt management policies. These elements should include, but not be limited to:

a. Debt limits, including specific limits or ranges for each type of debt;
b. Debt structuring practices, including specific guidelines regarding the debt structuring practices for each type of bond;
c. Debt issuance practices with guidance on the issuance process, including selection policies and criteria;
d. Debt management practices regarding the ongoing administration of debt, as discussed in detail in Section 4, starting on page 57, of this report; and
e. A clear statement regarding whether the County can or should use derivatives.

SAVINGS, BENEFITS, AND COSTS

A revision to the County's Debt Management Policy will require one-time personnel costs for Finance Agency staff time, as well as Board of Supervisors time to review and approve the proposed changes. However, as established in the Debt Management Policy itself, review of and revisions to the Debt Management Policy are already a responsibility of the Finance Agency. More detailed and thorough debt management policies will benefit the County by reducing the risk of injudicious or unnecessary use of debt and poorly structured debt or repayment schedules. Improved policies will also aid policymakers in evaluating proposed debt issuances and contextualizing the County's debt portfolio performance overall.

Section 3: Reliance on Lease Revenue Bonds

Background
The two long-term financing instruments most commonly used by California counties are general obligation bonds and lease revenue bonds. Santa Clara County has relied more heavily on lease revenue bonds for financing, primarily because the process for issuing these bonds is typically simpler and more time-efficient (they do not require voter approval). However, lease revenue bonds carry higher costs to the borrower, due to the higher risk for investors, which credit rating agencies typically rate less favorably than general obligation bonds.

Problem, Cause, and Adverse Effect
Since FY 2012–13, the County's annual costs of debt issuance have ranged from $300,000 to $1.6 million. Despite the higher cost of financing with lease revenue bonds, which was clearly documented in a report to the Board of Supervisors in 2016 that showed over $40 million in increased debt service to fund a $250 million capital project, County officials have noted that the cost differential bears less significance in Santa Clara because the County has received high ratings from the major credit rating agencies.

Santa Clara's reliance on lease revenue bonds, as measured by lease revenue bonds as a percentage of total governmental debt, was higher than the median for the 10 most populated California counties. As discussed in Section 2, starting on page 37 of this report, the County's debt management policy does not include specific borrowing thresholds for different financing instruments, including lease revenue bonds. Currently there is no control in place to constrain the County's issuance of lease revenue debt. If revenues were to be impacted by changing economic conditions or increased pressure on the General Fund to support hospital operations, it could raise the risk that credit rating agencies will lower the County's ratings.

Recommendations
In order to minimize General Fund costs for financing and to preserve the County's currently high credit ratings, the Finance Director should establish clear thresholds and guidelines for borrowing on all debt instruments. The Finance Director should also present detailed financing scenarios to the Board of Supervisors when prospective debt issuances are under consideration. These scenarios should include multiple instruments and long-term costs implications that reflect ongoing operating costs.

Savings, Benefits, and Costs
The purpose of these recommendations is to ensure that the County considers all opportunities to finance public projects at the lowest costs. The County's existing contract with its municipal advisor already includes the preparation and presentation of these financing scenarios in its scope; there would be no additional cost to the County to implement.

FINDING

Background

As noted in the Introduction to this report, long-term debt obligations can impact a government agency's credit rating. Credit rating agencies issue "ratings" on government debt to provide opinions about that issuer's relative credit risk and the issuer's ability and willingness to meet financial obligations in full and on time.[12] The standardization of the rating process is meant to offer information to investors that is consistent across sectors and regions.

Measures evaluated by the rating agencies include: institutional framework (e.g. ability to forecast revenues and expenditures), state of the economy (e.g. per capita income), financial management (e.g. long-term financial/capital planning and debt/reserve policies), performance on specific financial measures (e.g. liquidity), and debt and other liabilities (e.g. net direct debt as a percentage of total governmental funds revenue).

In general, high credit ratings provide access to the capital markets at the most competitive and cost-effective interest rates for taxpayers, while lower ratings indicate an increased credit risk and can incur higher borrowing costs.

Figure 3.1 on page 49 shows the ratings scales for two of the major credit rating agencies—Standard & Poor's (S&P) and Moody's—and descriptions of those ratings.

12 Standard and Poor's "How to Improve Your Bond Rating", 2013.

Figure 3.1: *S&P and Moody's Rating Scales*

Rating Description	S&P	Moody's
Prime	AAA	Aaa
High Grade	AA+	Aa1
	AA	Aa2
	AA-	Aa3
Upper Medium Grade	A+	A1
	A	A2
	A-	A3
Lower Medium Grade	BBB+	Baa1
	BBB	Baa2
	BBB-	Baa3
Non-Investment Grade Speculative	BB+	Ba1
	BB	Ba2
	BB-	Ba3
Highly Speculative	B+	B1
	B	B2
	B-	B3
Substantial Risk	CCC+	Caa1
Extremely Speculative	CCC+	Caa2
In Default with Little Prospect For Recovery	CCC-	Caa3
	CC	Ca
	C	Ca
In Default	D	C
	D	/
	D	/

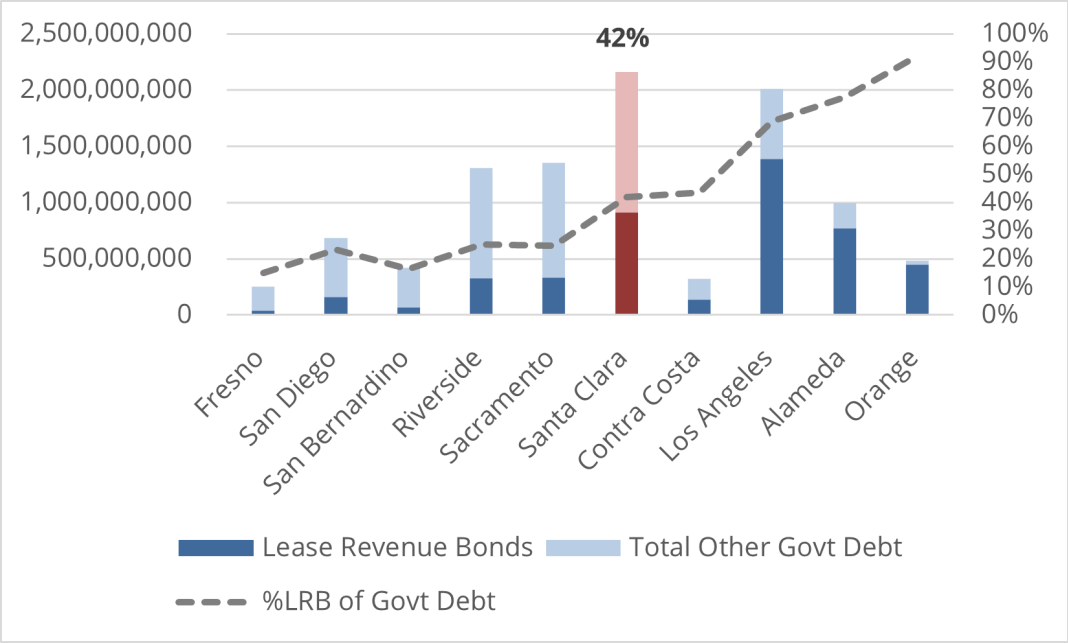
Because of the increased risk associated with lease revenue bonds, the credit rating agencies typically rate them one notch lower than general obligation bonds.

Santa Clara's Reliance on Lease Revenue Bonds Compared to Other Counties

Although Santa Clara is not the only California county from our comparative analysis that relies heavily on lease revenue bonds for financing, when compared to two of the three selected peer groups, Santa Clara's lease revenue debt as a percentage of total government debt was higher than the median.

As shown in Figure 3.2 below, of the 10 most populous counties in California, Santa Clara has the fifth highest lease revenue debt as a percentage of total governmental debt. The median for this group, as of June 2020, was 34 percent. Santa Clara's share was 42 percent.

Figure 3.2: *Lease Revenue Debt as a Percent of Total Government Debt, June 2020, 10 Most Populated CA Counties*



Source: FY 2019–20 Audited Financial Statements.

Higher Costs of Lease Revenue Bonds

The interest rates on lease revenue bonds are typically higher than general obligation bonds because general obligation bonds are backed by earmarked property taxes approved by voters. Because of the security provided by this voter-approved property tax guarantee, investors consider general obligation bonds to be safer. The higher cost of financing projects through lease revenue bonds can be observed both in the cost of issuance and the total net debt service.

Figure 3.3 on page 51 shows the County's cost of issuance for each debt issuance between 2012 and 2020. These numbers reflect the direct[13] costs of issuance, which include fees to the County's municipal advisor, bond counsel, disclosure counsel, trustee, rating agencies, and other related fees.

13 An indirect cost of issuance is the underwriter's discount, which is deducted directly by the underwriter from the proceeds of the bonds at closing.

Figure 3.3: *Costs of Issuance per $1,000 Par Amount, by Debt Issued*

Issuance	Par Amount	Cost of Issuance (COI)	COI $ per $1,000
2013B GO	490,000,000	600,000	1.22
2017C GO (VMC)	290,510,000	495,000	1.70
2017A GO (HOUSING)	250,000,000	470,000	1.88
2019A, 2019 A-T LRB (hospitals)	277,180,000	830,000	2.99
2018A LRB CHAMPION POINT	164,355,000	527,240	3.21
2016Q LRB	168,345,000	550,000	3.27
2015P LRB	102,435,000	510,000	4.98
2018A LRB VMC	55,090,000	285,000	5.17
2012A LRB	86,920,000	550,000	6.33
2015 NCREB	32,999,851	209,500	6.35
2016A LRB	41,810,000	325,000	7.77
2020A LRB FIRE DISTRICT	29,585,000	350,000	11.83
2014O LRB	11,715,000	265,000	22.62

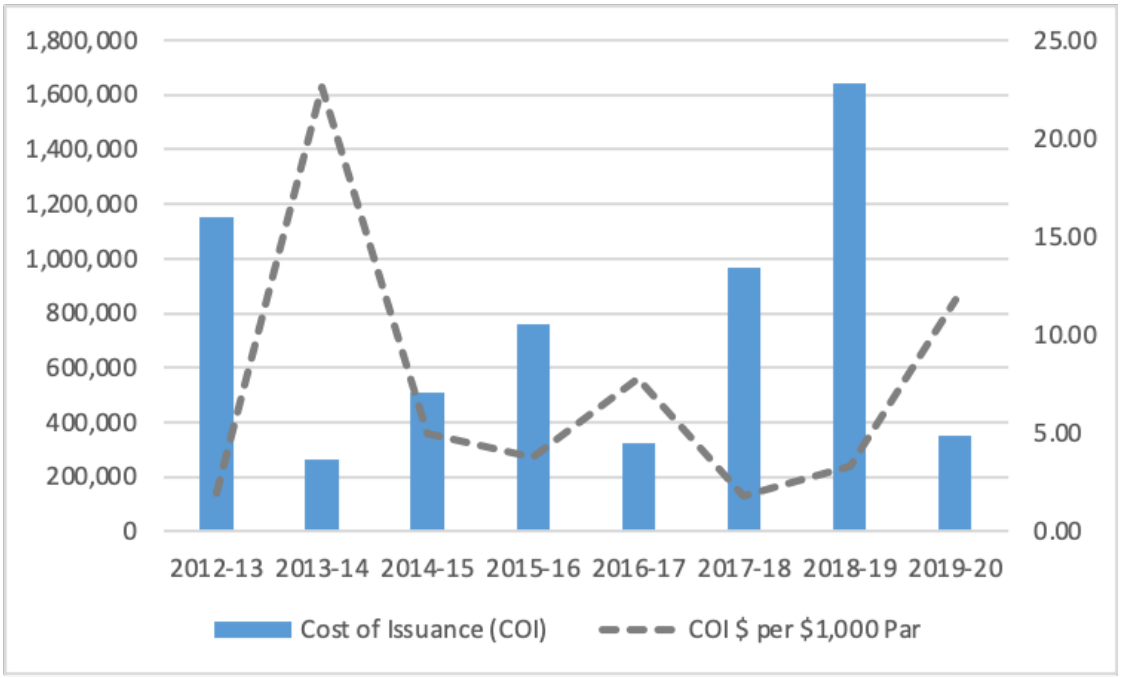
Source: Final Issuance Reports from County's Financial Advisor.

As shown above, the cost of issuance to the County per $1,000 par amount ranged from $1.22 to $22.62, for the 13 issuances since 2012. The lowest costs of issuance were for the three general obligation bond issuances: $1.22, $1.70, and $1.88, respectively. The costs of issuance for these general obligation bonds were significantly below the average of $6.10 for all of the issuances since 2012.

The costs of issuance per $1,000 were lowest for the largest issuances and highest for the smallest issuances. This suggests that the County could incur lower costs of issuance per $1,000 if it issued fewer, larger issuances.

Over the last eight fiscal years, annual costs of issuance for debt have ranged from $300,000 to $1.6 million as shown in Figure 3.4 on page 52. The average annual costs of debt issuance over this period was $700,000. Note that in some years the County authorized multiple debt issuances.

Figure 3.4: *Total Annual Costs of Debt Issuance, FY 2012–13 to FY 2019–20*



Source: Final Issuance Reports from County's Financial Advisor.

According to a report dated May 31, 2016 from the Finance Agency Director to the County Executive, in a particular scenario to fund a $250 million capital project, the difference in total net debt service between issuing GO bonds and lease revenue bonds was over $40 million.

Notably, in California, general obligation bonds must be approved by a two-thirds vote of the electorate. This presents challenges to local governments who may need to access the financing sooner than an election would allow, as well as the potential risk that the voters will not approve the bond measure by two-thirds, making the issuance of lease revenue bonds the more expedient, and more costly, option for financing.

Potential Impact on County's Credit Rating

While Santa Clara currently maintains high credit ratings, of the 12 peer counties for which we could identify recent credit ratings, four (or one-third) of those counties were ranked higher by Moody's as shown in Figure 3.5 on page 53. Those counties include Alameda, San Diego, San Francisco, and San Mateo.

Figure 3.5: *Credit Ratings of Peer Counties, as reported in FY 2020 CAFR*

County	S&P	Moody's
San Diego	AAA	Aaa
Alameda	AAA	Aaa
San Fransisco	AAA	Aaa
San Mateo	AAA	Aaa
Los Angeles	AAA	Aa1
Santa Clara	**AAA**	**Aa1**
Contra Costa	AAA	Aa1
Orange	AA+	Aa1
San Bernardino	AA+	Aa1
Stanislaus	AA-	A1
Riverside	AA	Aa3
Kern	AA	Aa
Sacramento	A1	A1

Source: FY 2020 Audited Financial Reports.

In its most recent credit opinion, issued on February 11, 2020, Moody's noted that the strong local economy and conservative fiscal management as two of the County's credit strengths that lend it an Aa1 "stable" rating. The opinion also points out credit challenges facing the County, including:

1. Above-average pension and OPEB liabilities
2. Santa Clara Valley Medical Center's reliance on the County for operational support.

The report further identifies "weakened hospital operations that materially increase reliance on the county's general fund" as a factor that could lead to a downgrade in the credit rating.

Standard & Poor's offered a similar assessment in its June 2020 report, noting that "The county intends to issue a total of $700 million in additional bonds over the next three years for a jail project, capital improvements for VMC, and an inpatient psychiatric facility. We do not believe that the planned issuances will weaken the county's debt metrics." It also cautions that "should the county's budgetary performance deteriorate beyond our current estimates as a result of a material reduction in revenues or additional budgetary pressure to support the VMC system, resulting in a significant weakening in reserves, we could lower the ratings."

Lack of Clear Thresholds for Borrowing

It is unclear how the County determines what type of debt to issue, and when it should issue lease revenue bonds to finance a capital project. As discussed in Section 2, starting on page 37 of this report, the County's debt management policies do not establish explicit thresholds for lease revenue borrowing. County officials provided inconsistent and vague references to our project team regarding the thresholds used to determine what type of financing the County uses. The statements to our project team included:

> *If the project costs less than $50 million, we fund it with cash. If the project costs over $100 million, we fund it with GO bonds. Projects costing between $50 million and $100 million are funded with LRBs.*
>
> *If the project costs over $65 million, funded with debt.*
>
> *Deciding what type of bond to issue for the hospital was easy because the hospital is a business-like function, so fundamentally LRBs were a clear choice, because of the ongoing revenue streams from the buildings.*

The hospital acquisition in 2019 was funded with lease revenue bonds, rather than GO bonds, despite costing $277 million. According to the County Executive, GO bonds could have been considered for this project. Instead, County staff recommended the issuance of lease revenue bonds to the Board for its approval.

Following the completion of the fieldwork related to this study, in June 2021, the County issued $358 million in additional lease revenue bonds to fund the renovation of the Adolescent Behavioral Health Center. The annual debt service costs are approximately $18 million, for a 30-year term. The financing scenarios for this issuance produced by the County's municipal advisor and presented to the Board of Supervisors on March 3, 2021 offered only lease revenue bond options (with "base case" and "accelerated case" alternatives). The Board of Supervisors was not able to consider the cost differential that might have been available through the issuance of general obligation bonds rather than lease revenue bonds.

CONCLUSION

Santa Clara County has maintained a strong economy over the past decade, which has been reflected in strong credit ratings from the major credit rating agencies. However, the County has relied heavily on lease revenue bonds for public financing, at a higher cost to the County versus general obligation bonds. Santa Clara's reliance on lease revenue bonds, as measured by lease revenue bonds as a percentage of total governmental debt, was higher than the median for the 10 most populated California counties.

The County currently lacks any defined threshold to constrain borrowing in order to mitigate the risks of excessive borrowing. As a result, the County is at greater risk of jeopardizing its current financial position and should institute stronger controls to ensure it acts prudently when considering public financing instruments.

RECOMMENDATIONS

The County Director of Finance should:

3.1 Establish clear thresholds and guidelines (similar to Butte County and the City and County of San Francisco) to ensure proper limits for all debt instruments to reduce County costs and risks to credit ratings and incorporate these in the County's Debt Management Policy. (Priority 2)

3.2 Present multiple financing scenarios to the Board of Supervisors when debt issuances are under consideration. These scenarios should include multiple instruments (specifically GO Bonds for larger projects) and long-term cost implications that include operating costs. (Priority 2)

The Board of Supervisors should:

3.3 Consider recommending that the County support or sponsor legislation to lower the State's voter approval threshold for general obligation bonds from two-thirds to 55 percent, similar to what is required of school districts.

SAVINGS, BENEFITS, AND COSTS

The purpose of these recommendations is to ensure that the County considers all opportunities to finance public projects at the lowest costs. As the County's existing contract with its municipal advisor already includes the preparation of these financing scenarios in its scope, there would be no additional cost to the County to implement these recommendations.

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Section 4: Internal Management

Background
Best practice for post-issuance debt management, as defined by the Government Finance Officers Association (GFOA), calls for formalized and documented policies and procedures to assist bond issuers in complying with laws and regulations.

Problem, Cause, and Adverse Effect
Despite the significant and growing debt burden under its purview, the County has not reviewed or updated its Debt Internal Control policies and procedures since 2017. It is unlikely that current staff have received any training on the County's existing "Debt Internal Control" policies, as this document was not provided to the project team until two weeks after the exit conference, despite our requests for all debt management policies at the entrance conference, in the initial request for information, and in subsequent interviews with staff.

Although our review of practices, including a sample of transactions, indicates that internal controls exist, the lack of formalization leaves the County at risk of violations, particularly in the event of staff turnover. Examples of violations that the County is at an elevated risk for include failure to meet disclosure obligations and missed debt service payments. The County risks regulator penalties, credit rating agency downgrades, and higher costs of borrowing without sufficient policies and procedures in place.

Recommendations
To protect the County from the risks of non-compliance, we recommend that the County Director of Finance update and expand the internal policies and procedures for post-issuance debt management, including at a minimum all recommendations from the GFOA, and ensure that all current and future staff responsible for debt administration and management receive adequate training on these policies and procedures.

Savings, Benefits, and Costs
Reviewing and updating internal policies and procedures will require staff time, but the amount of staff time should not be substantial. The benefit of the protections that these would offer the County cannot be quantified, but given the County's current outstanding debt obligations exceeding $2.3 billion, should not be underestimated.

FINDING

Background

As detailed in the County's Annual Debt and Swap Report for FY 2019–20, the

> *Finance Agency shall be responsible for managing and coordinating all activities related to the issuance and administration of debt, including the implementation of internal control procedures to ensure that the proceeds of debt are directed to the intended use…The Finance Agency is responsible for the County's debt administration activities, particularly the timely payment of debt, investment of bond proceeds, monitoring compliance with bond covenants, continuing disclosure, and arbitrage compliance for tax-exempt bonds.*

The County's Debt Management Unit within the Finance Agency consists of two Debt Management Officers and one Senior Accountant who report to the Treasury Administrator—a position that was vacant from September 21, 2020 to March 21, 2021. These three staff carry out the bulk of the administrative duties related to debt management, with the support of the County's financial advisor, bond counsel, and County Counsel.

Outdated and Insufficient Policies and Procedures

Despite the significant and growing debt burden under its purview, the Debt Management Unit has not updated its policies and procedures detailing roles and responsibilities in order to mitigate the risk of violation since 2017. It is unlikely that current staff have received any training on the County's existing "Debt Internal Control" policies, as this document was not provided to the project team until two weeks after the exit conference, despite our request for all debt management policies at the entrance conference, in the initial request for information, and in subsequent interviews with staff.

GFOA Best Practice

According to the Government Finance Officers Association (GFOA), the leading national public financial management organization,

> *issuers of bonds or other debt obligations should develop and adopt formal, written post-issuance compliance policies and procedures to assist in meeting compliance requirements and in preventing, identifying, and correcting possible violations that might occur during the term that bonds are outstanding.*

The GFOA specifically recommends that issuers:

- Identify responsible staff;
- Identify the documents that set forth all of the requirements being monitored;
- Identify the frequency of the actions to be undertaken;
- Monitor for changes in law and regulations;
- Establish a deadline reminder system;
- Identify records to be maintained and the record retention period;
- Require training for responsible officers;
- Describe procedures to identify and correct violations; and
- Adopt and document a post-issuance program

The GFOA also recommends that issuers review the post-issuance policies every year.

County's Debt Internal Control Policy

As noted above, the County did not provide the project team with a copy of the "Debt Internal Control Policy" until 14 days after the exit conference concluded. Given that this document had been requested several times during the course of the project fieldwork, including through our initial request for information and through staff interviews, we believe it is unlikely that current Debt Management Unit staff have been trained or made aware of this policy.

According to the "Debt Internal Control Policy," the purpose of the policy is to "establish internal control procedures related to the issuance and administration of debt by the County." The functions of post-issuance debt management that are referenced in the policy include:

- Use of bond proceeds;
- Compliance with laws and regulations;
- Arbitrage rebate;
- Continuing disclosure;
- Debt service payment; and
- Audits.

Of the nine guidelines established by the GFOA, the County's Debt Internal Control Policy only fully complies with one. The County policy partially complies with three guidelines; the remaining five GFOA standards are not reflected at all in the County policy. Figure 4.1 on page 60 details the comparison of the County's policy with GFOA standards.

Figure 4.1: *GFOA Standards versus County Policy*

GFOA Best Practice	County Policy Compliance
Identify responsible staff, specifically a "Chief Compliance Officer"	Partial: County policy identifies responsible unit, not individual or position
Identify the documents that set forth all of the requirements being monitored	No
Identify the frequency of the actions to be undertaken	No
Monitor for changes in law and regulations	Yes
Establish a deadline reminder system	No
Identify records to be maintained and the record retention period	No
Require training for responsible officers	Partial: County policy does not reference training on internal procedures, only that "any County personnel involved in conducting [reviews of federal tax and securities requirements] may receive periodic training"
Describe procedures to identify and correct violations	No
Adopt and document a post-issuance program	Partial: County policy does not indicate the frequency of review of procedures

Source: GFOA Best Practice on Post Issuance Policies and Procedures; County Debt Internal Control Policy.

The "Revision History" section at the end of the policy document indicates that it was a "new policy," created on November 6, 2017. It appears that the County has never revised this policy, which the GFOA indicates should occur annually. The County itself has acknowledged the importance of this in the policy itself:

> *This policy establishes internal control procedures to ensure proper segregation of duties is in place for authorization and processing of debt repayments and that the proceeds of any debt issuance are directed to the intended use. Such procedures shall assist the County in maintaining the effectiveness and efficiency of operations, properly expending funds, reliably reporting debt incurred by the County and the use of proceeds, complying with all laws and regulations, preventing fraud, and avoiding conflict of interest.*

Sampling of Transactions Shows Compliance

From our review of sampled transactions, we found that the staff of the Debt Management Unit utilize checklists and follow informal practices to ensure compliance with regulations.

In addition to the Debt Service Payment flow chart, we reviewed copies of reimbursements and invoices related to three issuances: the 2017 Series A general obligation bonds, the 2018 Series A lease revenue bonds, and the 2019 Series A lease revenue bonds. These documents showed signatures (indicating review) by two County employees, with clear documentation of bond, project, and remaining balance.

Other internal controls used by the Debt Management staff to ensure timeliness of payments include task lists, payment reminders, and regular payment monitoring. County Counsel also provides additional support to the Debt Management Unit by reviewing transactions, regularly for payments related to the Affordable Housing general obligation bond, but also on an as-needed basis.

While the processes in place appear to reflect compliance from our sampled review, without the formalization of policies and practices in written manuals, the County leaves itself vulnerable to non-compliance, particularly in the instance of staff turnover and the loss of historical knowledge.

Key Leadership Vacancies

Until April 2021, for approximately seven months, the County's Treasury Administrator position remained vacant, even as the County continued to issue debt – $29,585,000 in lease revenue bonds were issued during this time, as the County carried $2.3 billion in ongoing long-term obligations.

During this period, there was no individual directly responsible for the oversight and management of the County's debt portfolio or for improving the County's debt management policies. This absence of directly accountable leadership coupled with inadequate management policies put the County at risk of injudicious or unnecessary use of debt, poorly structured debt or repayment schedules, and a failure to meet disclosure or tax obligations. Improperly managed debt also carries financial risks, including cash shortfalls, missed debt service payments, and the failure to call or refund debt to take advantage of changing market conditions. Ultimately, the potential results of insufficient management include regulator penalties, credit rating agency downgrades and resulting borrowing cost increases, and a lack of investor and taxpayer confidence.

Survey of Debt Management Organizational Structure

As noted in the Methodology section, starting on page 15 of this report, we distributed a survey to all 15 counties of our three peer comparison groups to collect detailed information about internal management policies and practices. Of the 15 counties, nine provided responses. Figure 4.2 on page 62 summarizes the staffing and organizational placement of the debt management function in the nine responding counties.

Of the nine counties that responded to our survey, eight were fully completed while one (San Joaquin) was returned without all the requested information. The responding counties have, on average, four full time equivalent (FTE) positions assigned to carry out debt management functions, which organizationally fall under the purview of the County Administrator (e.g. Chief Executive, County Manager, County Administrative Officer, etc.) in five counties (56%) and the Auditor-Controller/ Treasurer-Tax Collector in the remaining four counties (44%).

Figure 4.2: *Peer Survey Results*

County	Organizational Structure	Number of Staff
Contra Costa	County Administrator and Department of Conservation & Development	1 FTE (~ 2 positions)
Fresno	Auditor-Controller/Treasurer-Tax Collector	6 FTE
Los Angeles	Treasurer and Tax-Collector	7 FTE
Orange	County Executive Office (Public Finance Division)	4 FTE
San Diego	Executive Office	2 FTE
San Francisco	Controller's Office	6 FTE
San Joaquin	County Administrator and San Joaquin County Public Facilities Financing Corporation (PFFC)	N/A*
San Mateo	County Manager's Office and Department of Public Works	1.5 FTE
Santa Clara	Controller's Office	3 FTE
Stanislaus	Treasurer-Tax Collector (Primary)	0 FTE**

Notes:
** San Joaquin did not fully complete the survey.*
***No employees are assigned to debt management as a full-time position. Stanislaus County currently does not have any outstanding public debt, other than Tobacco Securitization.*

CONCLUSION

The County has not reviewed and updated its Debt Internal Control policies and procedures since 2017. A review of these policies and procedures found that it does not comply with eight of the nine guidelines recommended by the Government Finance Officers Association (GFOA). Further, it is unlikely that current staff have received any training on the County's existing "Debt Internal Control" policies, as this document was not provided to the project team until two weeks after the exit conference, despite our requests for all debt management policies at the entrance conference, in the initial request for information, and in subsequent interviews with staff.

While the current staff responsible for these activities demonstrate competence and expertise, the lack of sufficient documented policies puts the County at an elevated risk should there be staff turnover or any loss of this historical knowledge. With outstanding debt obligations now over $2.3 billion, the County should follow GFOA best practices to enhance and regularly update its internal debt management practices.

RECOMMENDATIONS

The County Director of Finance should:

4.1 Review and update the "Debt Internal Control Policy" annually, as recommended by the GFOA, to ensure that it sufficiently details internal policies and procedures for post-issuance debt management, including at a minimum all recommendations from the GFOA. (Priority 3)

4.2 Ensure that all current and future staff responsible for debt administration and management receive annual training on these policies and procedures. (Priority 3)

SAVINGS, BENEFITS, AND COSTS

Reviewing and updating internal policies and procedures will require a moderate amount of staff time, but it should not be unduly labor intensive.

While we cannot quantify the benefit to the County of producing these policies, given the size of the County's existing long-term debt load, the value of the assurance these protocols would provide regarding regulatory compliance is significant.

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Section 5: Use of Advisors

Background
In accordance with best practice, as established by the Government Finance Officers Association (GFOA), the County contracts out for financial advisory services to provide expertise in structuring and issuing bonds.

Problem, Cause, and Adverse Effect
While engaging the services of a financial advisory firm to support bond issuances aligns with best practice, the County's *process* for selecting and managing this firm do not align with GFOA best practice. As noted in GFOA guidance, "finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable." The County has contracted with the same financial advisory firm for public finance projects since at least 2011. Although this firm has been selected through a competitive bid process, the County's request for proposals required that bidders provide both an hourly fee schedule and a proposed flat-fee schedule for services related to the issuance of bonds. According to the contract, the firm did not provide this schedule of fees, which are not accounted for in the not-to-exceed amount in the most recent contract. This contract established a not-to-exceed amount for financial advisory services of $240,000, but the firm has received over $1 million as of June 2021—most of which was for bond issuance transaction fees. The true costs of these financial advisory services are not reflected in the contract, and it does not appear that the County has made any attempt to reduce costs for these financial services.

Recommendations
To align with best practices and ensure that debt issuance costs are minimized, the County Director of Finance should require that all future bidders for debt issuance financial advisory services provide schedules reflecting the range of potential transaction fees in their proposals to the County, which should then be reflected within the final terms of the contract.

Savings, Benefits, and Costs
There would be no additional costs to the County to implement these recommendations in future procurement processes. Conservatively, we estimate that a 10 percent savings could be achieved through a more transparent competitive process, which would save the County approximately $20,000 per year, based on the transaction costs over the last five years. Actual cost savings would depend on proposals submitted by prospective contractors.

FINDING

No Clear Limits on Transaction Fees for Financial Advisor

Although the County's financial advisory firm proposes transaction costs related to individual debt issuances for approval, the current contract terms do not establish any clear guidelines or standards for these fees. The not-to-exceed amount for the contract does not include transaction fees—which represent the overwhelming majority of costs paid to the firm—at all. Since 2016, the financial advisor has received over $1 million in fees on a contract with an original not-to-exceed amount of $240,000. In addition, it appears that all proposed transaction fees have been approved by the County as proposed by the financial advisor.

In 2021, the County extended the firm's contract for two additional years through the Voluntary Vendor Cost Reduction Initiative which requires participating vendors to agree to a 15 percent reduction in costs. Notably, although the transaction fee services are part of the scope of work attached to this contract, compensation for those services appears to be exempt from the 15 percent cost reduction requirement. While the fees are not paid directly from the General Fund, they increase the County's cost of borrowing, and the County should enhance its efforts to constrain them.

GFOA Best Practice

The Government Finance Officers Association[14] (GFOA) has established two best practices related to financial advisory services: (1) Selecting and Managing Municipal Advisors, and (2) Debt Issuance Transaction Costs.

For "Selecting and Managing Municipal Advisors," the GFOA recommends that issuers:

- Hire a municipal advisor…unless the issuer has sufficient in-house expertise and access to current bond market information.
- Select municipal advisors on the basis of merit using a competitive process [such as a request for proposals (RFP)].
- Include [in the RFP] a requirement that all fee structures be presented in a standard format.
- Have a written contract for municipal advisory services that should detail the scope of services and basis of compensation.

It is unclear how the County evaluated the current financial advisor's proposal relative to others on costs as the winning proposal did not include a schedule or structure for transaction fees.

14 As noted in Section 4, starting on page 57 of this report, the Government Finance Officers Association (GFOA) is the leading industry organization for public finance management.

In its "Debt Issuance Transaction Costs" guidance, the GFOA states that "finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable and for legitimate services provided to the issuer." The guidance further notes that:

> *compensation paid to financial advisors can vary based on the scope of services to be provided. If an advisor is being retained for services related to a bond transaction, then the complexity of the transaction, the type of security and the type of issuer will have an impact on the fees charged. Fees can be paid on an hourly, or fixed fee basis. However, the fee may also be based on an $/$1,000 of par value. However, an issuer should use caution if using this payment method as it could impact the overall size and structure of the transaction.*

Financial Advisory Services

The County currently contracts out for "financial advisory services for public finance projects" through a competitive solicitation process, conducted most recently in April 2016. The scope of work includes:

- Evaluate the County's indebtedness and make recommendations for refunding and restructuring the debt portfolio.
- Assist in developing policies related to debt financing and administration.
- Provide market data, including interest rate and fee comparables.
- Educate County staff about new products or current issues in the municipal bond market.
- Educate the County's elected officials about the bond market.
- Assist the County in the selection process for other service providers and provide input in developing the scope of work of such providers. Assist in evaluating performance and resolving issues as necessary.
- Assist in preparing presentations and representing the interests of the County to credit rating agencies, credit enhancement providers, and potential investors, as requested.
- Attend meetings as necessary. Prepare or assist in the preparation of reports or memoranda outlining recommendations to the County. Make presentations to the County Board of Supervisors, County Executives or other groups as requested.
- Advise, as requested, on financing methods, structures, and feasibility of issuing debt for projects under consideration. Develop, as requested, debt strategies and recommend financing mechanisms that would allow the County to undertake future financings in a manner that most efficiently meets the County's goals and objectives.
- Develop, as requested, financing plans with County staff, bond counsel, and other members of the financing team that are consistent with the needs of the projects to be financed. Recommend financing structures, to include specific terms such as call provisions and escrow features, and prepare estimated debt service schedules. Outline the advantages and disadvantages of particular financing mechanisms.

- Recommend, as requested, a method of sale and provide the following services:
    - Advise as to securities market conditions and timing of sale.
    - Should the County elect to offer its securities through a competitive or semi-competitive sale, the Proposer shall distribute the official notice of sale and bid form and the preliminary statement to prospective underwriters. ...
    - Should the County elect to offer its securities through negotiated sale, the Proposer shall assist the County in the selection of an underwriter, identify comparable transactions to determine preliminary market pricing
- Coordinate the printing and distribution of the official statement to be used in connection with the offering of the bonds with disclosure counsel.
- Coordinate, as requested, the work of the financing participants, County staff and bond counsel to ensure that the financing closes in a prompt manner. ...
- Assist in planning for the investment of transaction-related and trustee-held funds. ...
- Prepare post-sale summary document including results of competitive sale, comparison to market at time of sale, final debt service schedules, discussion of bond structure, and sale results.
- Provide advice or undertake financial analyses or other projects on such additional matters as may be requested by the County from time to time.

County's Request for Statement of Qualifications

In Appendix C of the County's Request for Statement of Qualifications, the Proposer's Cost Proposal, the County requests:

> *Proposer shall provide proposed hourly fee schedule for providing the financial advisory services described in Scope of Services section. Additionally, where applicable, provide a proposed flat-fee schedule for services related to the issuance of the bonds.*

While the selected firm provided an hourly rate schedule, it did not provide a schedule for the flat-fees associated with "on-call" advisory or pre-transaction services. The firm noted in its proposal that:

> *the County's Request for Statement of Qualifications doesn't specify particular transactions and, even then, it is difficult to provide a 'flat-fee' schedule without knowing more about the specifics of a particular financing. Generally, [the firm] bases its transaction fees on the complexity of a bond issue, rather than based exclusively on par amount or security type. By way of example, fees for a competitive sale may differ from those for a negotiated sale...Overall, many factors may impact complexity including, but not limited to, bond type, interest rate mode, par amount, refunding vs new money, number of series, number of projects... We also typically would charge more for a refunding transaction than for a new money transaction, to reflect additional complexity involved with refundings.*

Transaction Fee Payments

In lieu of a schedule for transaction fees, the firm is required to propose a specific fee at the time a financing plan has been established for a particular financing. According to the bid/contract, "Thus, for transaction services, [we] would propose a specific fee at the time a financing plan has been established for a particular financing. At that time, we would provide the County with a fee proposal, in a written memo with factors supporting the proposed transaction fee."

Despite the established not-to-exceed amount of $240,000 per the 2016 contract, the vendor has received at least $1.2 million under this contract. As shown in Figure 5.1 below, the County has paid "flat-fees" totaling $1,151,000 to this vendor for transaction costs related to bond issuances.

Figure 5.1: *Financial Advisory Fees for Issuances since 2016*

County Bebt Issuance	Fee
2016A LRB	$102,500
2017A GO HOUSING	155,000
2017C GO VMC	95,000
2018A LRB VMC	100,000
2018A LRB CHAMPION POINT	125,000
2019A, 2019 A-T LRB	170,000
2020A LRB FIRE DISTRICT	127,500
2021 LRB Capital Facilities	153,000
2021 GO Bonds	123,000
Total Financial Advisory Transaction Fees for Issuances	**$1,151,000**

Source: "Final Numbers" reports to County from firm.

The vendor stated in its proposal, which was codified in the final contract, its willingness to negotiate with the County on these fees, if necessary. Specifically, it stated:

> *If more information is needed now, [we] would be happy to discuss or provide the County with transaction fee ranges for particular security types. Given the importance of this engagement and our strong desire to continue our work with the County, [we are] amenable to negotiating whatever reasonable fee arrangement the County deems appropriate.*

However, from our review of the firm's fee proposals, as submitted in advance of each of the seven debt issuance between 2016 and 2020, the County simply approved all proposed amounts. It does not appear that the County has taken any steps to constrain the costs for the financial advisory services related to issuing debt. While those costs do not directly impact the General Fund, they do increase the overall cost of borrowing to the County, which can result in increased debt service payment requirements.

Contract Extension and Proposed Cost Reduction

The contract term for these services, as established in the April 2016 Request for Statement of Qualifications, was three years with two one-year options to renew. The County renewed the contract in FY 2019–20, and again in FY 2020–21. The contract was scheduled to fully expire on June 30, 2021. However, in November 2020, the Board of Supervisors approved the County's Voluntary Vendor Cost Reduction Initiative in an effort to address the County's structural budget deficit. Through this initiative, current contractors and vendors could seek a one- or two-year extension of their contracts in exchange for a 10 or 15 percent cost reduction, respectively.

In February 2021, the County's financial advisory contractor agreed to a two-year contract renewal for a 15 percent reduction in fees. The signed agreement indicates that "per the Department, average [annual] spend is approximately $10,000 per year." The estimated savings to the County from this 15 percent reduction in costs totaled $3,000 over the two years—or $1,500 per year. Despite the fact that the Department itself estimated only another $20,000 in costs for financial advisory services over the additional two years, the contract extension increased the firm's not-to-exceed amount from $240,000 to $290,000—an increase of $50,000.

As noted in Figure 5.1 on page 69, the firm received $276,000 in transaction fees for the 2021 bond issuances alone.

Practices of Other Bay Area Counties

In order to understand how Santa Clara's practices for contracting financial advisory services compare to other counties, we reviewed the most recent Requests for Qualifications/Proposals published by the City and County of San Francisco and Contra Costa County.

In San Francisco, fee schedules are set by the City itself, on a project-by-project basis, as described below:

> *The City will compensate selected Contractor(s) on an hourly basis up to a maximum amount. The City may choose to determine maximum amounts for various types of transactions via fee schedule provided by the City to be used by all contractors, subject to negotiations for each engagement at initiation to the extent that the selected Contractor can provide rationale and justification based on level of service engagement. The City reserves the right to set fees on a project-by-project basis.*
>
> *Please list the hourly billing rates for each employee that you anticipate being involved in any of the City's financings.*

San Francisco selects a pool of advisors for financial advisory services, which enables it to have some control over the costs related to transaction fees.

Contra Costa requires proposers for financial advisory services to provide a fee schedule of not-to-exceed costs by type of debt issuance and by range of par amount. According to the Request for Proposals issued in May 2021:

> *Compensation: The County wishes to enter in contracts that contemplate "not to exceed" compensation limits by 1) type of issuance, and 2) par-amount. It is also understood that firms provide critical services to issuers outside of a formal debt issuance process (e.g. assistance with post-issuance compliance or special projects, etc.). For that reason, it will be necessary to include an hourly rate structure to accommodate payment for those services, which may be necessary on an ad hoc basis. Please provide a proposal that includes:*
>
> - *The "not to exceed" amount for all work to be performed by the firm, by type of debt issuance and by range of par-amount, which shall include all costs for work performed from "kick off to closing";*
> - *Hourly rates for all individuals to be assigned to the County for consulting projects outside of a formal debt issuance process.*

Both of these RFPs offer alternative models for evaluating and establishing fees related to debt issuance transaction costs.

CONCLUSION

As currently communicated through the contract terms, it is unclear how policymakers and the public would know the actual costs of financial advisory services to the County. GFOA best practice guidelines state that, "finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable." In its request for proposals, the County required that bidders provide both an hourly fee schedule and a proposed flat-fee schedule for services related to the issuance of bonds. The flat fee schedule for bond issuances was not submitted by the successful bidder, and those fees are not accounted for in the not-to-exceed amount of the current contract. Without documentation of such a schedule, it does not appear that the County has made any attempt to reduce or constrain costs related to financial services. Our outreach to San Francisco and Contra Costa counties found alternative models for evaluating and establishing fees related to debt issuance transaction costs.

RECOMMENDATIONS

The County Director of Finance should:

5.1 Require all future bidders for debt issuance financial advisory services provide schedules reflecting the range of potential transaction fees in their proposals to the County. (Priority 3)

5.2 Ensure that the schedule for transaction costs, as provided by the successful bidders for financial advisory services, be reflected within the final terms of the contract. (Priority 3)

SAVINGS, BENEFITS, AND COSTS

There would be no additional costs to the County to implement these recommendations in future procurement processes. Conservatively, we estimate that a 10 percent savings could be achieved through a more transparent competitive process, which would save the County approximately $20,000 per year, based on the transaction costs over the last five years. Actual cost savings would depend on proposals submitted by prospective contractors.

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Finance Agency
Controller-Treasurer

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Date: November 18, 2021

To: Board of Supervisors, Management Audit Division

From: Margaret Olaiya, Acting Director, Finance Agency Margaret Olaiya

Subject: Response to Special Study of County Debt

The Administration takes this opportunity to thank the Harvey Rose Management Audit Team for the time and effort spent learning more about the County's debt management operations and processes. We appreciate the thoughts shared with us at the meetings and through the report, recognizing there is always room for continuous improvement, even in the most robust frameworks.

To ensure clarity for the audience, this response addresses statements of inaccuracies reported in the audit as Findings, and Administration's response to the Recommendations from the Management Audit Team.

Finding 1: Debt Issuance Transparency and Oversight
The County's debt affordability model is already in use to evaluate the impact of new debt on the County's credit rating. It should be noted that the credit rating is not the sole consideration in whether to issue debt. The main driver is the need for the County to finance projects that are necessary for operations and for serving the residents of the County.

The report states that "Though the Finance Agency reports that its Treasury unit maintains an internal Debt Affordability Model to evaluate affordability from a credit-rating perspective, the project team could not verify the practical implementation of this model."

This is a surprising statement given that the project team was given the updated model that was used for the two 2021 debt issuances and that the Budget Director verified that the model is used each year as part of the budget process.

The County Executive should:

Recommendation 1.1 Formally establish membership of the Administrative Capital Committee (which should include the County Counsel) and formally define the function of the Committee

Administration Response: Partially agree.

The County Executive will formally establish the membership of the Administrative Capital Committee and define the function of the Committee. County Counsel participation is always welcomed at Administrative Capital Committee meetings, but it is not necessary that County Counsel attend all meetings.

The County Director of Finance should:

Recommendation 1.2: Establish a formal orientation curriculum for all newly elected Board members with information related to the County's existing debt portfolio, the Supervisors' roles and responsibilities in the debt issuance process, and the County's process for issuing debt

Administration Response: Agree.

This training is already offered but can be formalized and offered on an annual basis.

Recommendation 1.3: Review the County's Debt Affordability Model and determine which, if any, changes need to be made in order for it to be used to evaluate the long-term affordability and budgetary impacts of proposed debt issuances. Once any needed changes have been made, immediately begin fully using the Debt Affordability Model to evaluate the long-term affordability and budgetary impacts of proposed issuances and include the results in materials presented to the Board of Supervisors.

***Administration Response*:** Partially agree.

The Debt Affordability Model is used annually as part of the budget process to understand the potential impact of the capital improvement program on the County's credit ratings and before any proposed bond issuance. To develop this model into something for budgetary purposes is not feasible, nor is it the best use for it. The Office of Budget and Analysis (OBA) has another model better suited and in current use for this purpose. OBA develops and publishes a five-year forecast annually in the Recommended Budget to communicate the long-term affordability and budgetary impacts of recommended debt issuances and all other recommended actions with a long-term impact.

Recommendation 1.4: Include the findings from the Debt Affordability Model analysis and other cost/benefit analyses in legislative files and other materials presented to the Finance and Government Operations Committee and/or the full Board of Supervisors related to proposed debt issuances. Debt affordability metrics should include, but not be limited to: total governmental funds debt service; debt par amount outstanding; estimated par amount and new debt service for proposed debt issuance; estimated total par amount and annual debt service including new debt issuance; direct debt compared to assessed valuation; debt per capita; and

total governmental funds debt service compared to expenditures.

***Administration Response*:** Agree.

Staff will include relevant and readily available metrics in legislative files and presentations. It should be noted that some of this information is included in the Recommended Budget under the section titled "Debt Service". The Controller-Treasurer Department and Office of Budget and Analysis will continue to work together to refine this section.

The County Budget Director should:

Recommendation 1.5: Include more detailed information and affordability metrics about proposed debt issuances and provide long-term strategic context on the County's overall debt portfolio in either the County's 10-Year Capital Improvement Plan or its Recommended Budget, and provide long-term strategic context on the County's overall debt portfolio. Debt affordability metrics should include, but not be limited to: total governmental funds debt service; debt par amount outstanding; estimated par amount and new debt service for proposed debt issuance; estimated total par amount and annual debt service including new debt issuance; direct debt compared to assessed valuation; debt per capita; and total governmental funds debt service compared to expenditures.

***Administration Response*:** Partially agree.

See responses to Recommendations 1.3 and 1.4. The "Debt Service" section of the Recommended Budget will continue to include relevant and available metrics, with more information added as it becomes available. The County's 10-Year Capital Improvement Program publication will continue to provide long-term strategic context, with more information added as it becomes available. These documents are published simultaneously as companion plans, providing important context for one another.

The Board of Supervisors should:

Recommendation 1.6 Amend the Rules of the Board of Supervisors to include a review of proposed debt issuances as a matter under the responsibility of the Finance and Government Operations Committee, so that all proposed debt issuances are heard first in the Finance and Government Operations Committee before being heard by the full Board of Supervisors

***Administration Response*:** No response

Recommendation 1.7 Consider establishing a Debt Affordability Advisory Committee, with formal membership, to review and make recommendations to the Finance and Government Operations Committee related to the County's debt issuances.

***Administration Response*:** No response

<u>Recommendation 1.8</u> Modify Board Policy 4.7.1 (Debt Management Policy) to require the Finance Agency to conduct an annual review of the County's Debt Affordability Model.

***Administration Response*:** No response.

Finding 2: Debt Management Policy and County Performance
As the audit team notes, "Research by the GFOA shows that in benchmarking debt statistics, the choice of comparable governments must be done with caution because no two communities are identical." After acknowledging this, the analysis then defines peer groups that include jurisdictions with as little as one common characteristic as the County – but potentially hundreds of differences including in the number of residents, their political leanings, and, of particular importance, the stage of their capital improvement programs. The County has been in a state of increased need for capital financing as a result of voter demand (affordable housing general obligation bonds) and growth in employee count (for example, the new Tasman facilities to replace leased offices). Using debt financing instead of cash to pay for these is reasonable as it ensures generational equity by spreading the costs over the useful life of the facilities.

Using Governmental Funds to calculate the debt as a percentage of governmental fund reserves is a problematic benchmark. For most counties this would exclude enterprise debt, such as hospital debt, from the calculation. For Santa Clara County, however, this includes enterprise debt for the Health and Hospital System because all debt was transferred to the General Fund a few years ago. Therefore, the debt amount is overstated for Santa Clara County compared to the peer group by $22.4 million (for fiscal year 2020-21) It should also be noted that this debt service is reimbursed by the Health and Hospital System on an annual basis.

While the County's debt management policy may not include all the elements recommended by the GFOA, the Administration disagrees that it is "without detailed and thorough debt management policies". Outside disclosure counsel, bond counsel and rating agencies cite the County's strong policies, including the debt management policy, as a credit strength of the County. Investor demand clearly demonstrates confidence in the County and its financial condition.

No debt can be issued without Board of Supervisors' approval, therefore there is no "elevated risk of injudicious or unnecessary use of debt." All debt structure decisions are made in collaboration with a Municipal Advisory firm, who has a fiduciary duty to its government clients pursuant to the Municipal Advisor Rule established by the Securities Exchange Commission (SEC) on July 1, 2014, so there is no risk of "…poorly structured debt or repayment schedules…" This is evidenced by the continued high credit ratings and strong investor demand for Santa Clara County debt.

The Finance Director should:

Recommendation 2.1 Review and propose revisions for consideration by the Board of Supervisors to Board Policy 4.7.1, the County's Debt Management Policy, to incorporate all elements recommended by GFOA as best practice for debt management policies. These elements should include, but not be limited to:

a. Debt limits, including specific limits or ranges for each type of debt;
b. Debt structuring practices, including specific guidelines regarding the debt structuring practices for each type of bond;
c. Debt issuance practices with guidance on the issuance process, including selection policies and criteria;
d. Debt management practices regarding the ongoing administration of debt, as discussed in detail in section 4 of this report; and
e. A clear statement regarding whether the County can or should use derivatives

***Administration Response*:** Partially Agree.

Administration will update the Policy and may make reference therein to a manual that can be updated more frequently than the Policy itself, thereby ensuring that all new legislation and regulations, as well as any changes in best practices, are captured on an annual basis.

Finding 3: Reliance on Lease Revenue Bonds

Lease revenue bonds are the most common form of municipal debt issued in California. General obligation bonds, while normally less costly for the issuing entity, are paid for by special assessments on property tax bills and therefore must be approved by a 2/3 majority of voters in a general election. Getting a bond measure on the ballot is a lengthy and costly process, making it impractical for most financing needs. Because of this, lease revenue bonds have become the norm.

Administration wants to emphasize that though the report states that the general obligation bond process makes the "issuance of lease revenue bonds the more expedient, and more costly, option for financing", the term "more costly" should be viewed in the proper context. The report implies that it is significantly more expensive to issue lease revenue bonds, which is not necessarily true. It is typically more expensive because it involves additional documentation, such as lease agreements, that must be reviewed by outside counsel and because investors typically view lease revenue bonds as slightly riskier than general obligation bonds. It is important to keep in mind, however, that the general obligation bond process is quite costly, and the cost of putting a bond measure on the ballot is not captured in the issuance cost of those bonds. The Board of Supervisors have the discretion to issue a general obligation bond which requires a majority vote by the residents of the County.

While lease revenue bonds are typically, although not always, more expensive to issue than general obligation bonds, the difference is not necessarily significant. It depends on the issuing entity's credit rating, the purpose of the bond issuance, market conditions at the time and other factors. Santa Clara County enjoys a very high credit rating and very strong investor demand, which results in strong competition for its bonds, which in turn reduces the cost to the County in

the form of lower interest rates.

The report received by the Board of Supervisors at the 06/07/2016 meeting was a hypothetical example written to illustrate the difference in financing costs between lease revenue bonds and general obligation bonds. It was not intended to malign the use of lease revenue bonds since lease revenue bonds, as discussed above, are often the only option for capital financing. In the hypothetical example, the difference in Total Net Debt Service between the general obligation bond and lease revenue bond financing option is approximately $41 million. This figure is cited multiple times in the audit report as an example of the cost difference between lease revenue bonds and general obligation bonds. However, as staff clarified to the auditors, it should be noted that those debt service numbers are in nominal dollars (i.e. spread out over the 30-year life of the bond). The net present value of the difference in debt service in that example would be approximately $25 million.

To establish borrowing thresholds for different financing types would unnecessarily create constraints for properly financing capital projects. This is not an investment portfolio where concentration risk is of concern, nor does this have a bearing on credit ratings.

We want to emphasize that credit rating agencies cite the County's strong management policies, strong local economy, and conservative fiscal management as some of the County's credit strengths.

The County Director of Finance should:

Recommendation 3.1 Establish clear thresholds and guidelines (similar to Butte County and the City and County of San Francisco) to ensure proper limits for all debt instruments to reduce County costs and risks to credit ratings and incorporate these in the County's Debt Management Policy

***Administration Response*:** Agree.

Administration will work with its municipal advisor to create a meaningful debt limit.

Recommendation 3.2 Present multiple financing scenarios to the Board of Supervisors when debt issuances are under consideration. These scenarios should include multiple instruments (specifically GO Bonds for larger projects) and long-term cost implications that include operating costs.

Administration Response: Partially Agree.

Prior to any bond issuance, the municipal advisors run several financing scenarios. Staff can attach those to the legislative files provided to the Board of Supervisors.
It should be noted, however, that there is limited benefit to the Board and the public of running scenarios involving general obligation debt in cases when such debt has not been

placed before the voters.

The Board of Supervisors should:

Recommendation 3.3 Consider recommending that the County support or sponsor legislation to lower the State's voter approval threshold for general obligation bonds from two-thirds to 55 percent, similar to what is required of school districts.

***Administration Response*:** No response.

Finding 4: Internal Management
While the County Treasury Administrator position was technically vacant from September 2020 to March 2021, the Director, Fiscal and Business Operations acted in the role during that time. There was not an "…absence of directly accountable leadership couple with inadequate management policies…" that "…put the County at risk of injudicious or unnecessary use of debt, poorly structured debt or repayments schedules, and a failure to meet disclosure or tax obligations."

As shown in the organizational chart, the debt unit is part of the Controller-Treasurer Department. In addition to the three staff in the unit itself, there is the County Treasury Administrator, the Assistant Controller-Treasurer, the Controller-Treasurer, and the Director, Finance Agency overseeing the program. Any debt issuance also involves County Counsel, the Office of Budget and Analysis as well as the County Executive's Office. Depending on the type of debt issued and the complexities associated with it, outside consultants may include bond counsel, municipal advisors, disclosure counsel, tax counsel, validation consultants, calculation verification agents and others. A vacant County Treasury Administrator position did not cause a severe lack of oversight of the process.

The Administration does review all its debt-related policies on an annual basis. The Disclosure Policy is updated each year because regulations change frequently. The other policies are updated as needed. The Administration does acknowledge that it is possible the Internal Controls policy inadvertently was not provided to the project team in a timely manner. However, to conclude based on that omission that "it is unlikely that current staff have received any training on the County's existing 'Debt Internal Control' policies" is unfounded and inappropriate. Staff are trained annually on all aspects of debt administration. All policies are reviewed by the Disclosure Committee at its annual meeting in February and they are also reviewed by the debt financing team and credit rating agencies before each bond issuance.

The policies are formalized in writing and available for staff and outsiders to review. The assertion that "the lack of formalization leaves the County at elevated risk of violations" is incorrect. Staff are properly trained in disclosure and administration procedures; the Disclosure Committee, which consists of County staff, bond counsel and disclosure counsel, meets annually to review all continuing disclosure requirements; and the County has a third-party contractor, Digital Assurance Corporation, which also assists with all continuing disclosure obligations. The

County has not missed any reporting requirements to date.

The report states that the County's policies are outdated and insufficient. Administration would like to point out that the credit rating agencies review our policies before issuing a credit rating on our bonds. S&P cited our policies as a strength in the latest rating: "We view the county's management as very strong with strong financial policies and practices…" They go on to list examples which include "Debt management policy that goes beyond statutory requirements, including a policy for swaps, and a practice of debt reporting in annual audits."

The Finance Agency Director should:

Recommendation 4.1 Review and update the "Debt Internal Control Policy" annually, as recommended by the GFOA, to ensure that it sufficiently details internal policies and procedures for post-issuance debt management, including at a minimum all recommendations from the GFOA

Administration Response: Partially agree.

The policy is already developed. Staff will continue the current practice of reviewing all policies, including the Debt Internal Control Policy, annually and revising them when necessary.

Recommendation 4.2 Ensure that all current and future staff responsible for debt administration and management receive annual training on these policies and procedures.

Administration Response: Agree.

This is the current practice.

Finding 5: Use of Advisors

The County has a contract with KNN Public Finance, LLC ("KNN") to assist with the issuance of bonds. KNN also advises staff on debt administration practices and provides training for staff. The report correctly states that KNN has a long-standing relationship with the County, but it should be noted that the County bids the contract every five years in accordance with County Procurement Policies. During the spring of 2021, staff took advantage of the County's pilot program, the Voluntary Vendor Cost Reduction Initiative, and extended the contract with KNN for an additional two years in return for a 15% reduction in the hourly rates. This was done because of staffing constraints during the pandemic (two of the debt management staff served as disaster service workers).

The relationship with KNN proved invaluable during the pandemic with minimal County staff. The consultants serve as extension of staff. They have the knowledge and history of past bond issuances prior to current staff's tenure with the County, and they were able to pick up some of

the administrative work otherwise done by staff.

The report states that "As noted in GFOA guidance, 'finance officers need to be aware of and understand the costs and fees that are charged in a bond transaction in order to ensure that the charges are reasonable.'" Staff discuss and approve any transaction costs prior to each bond deal. These reviews take into consideration the complexities surrounding the deal (for example, the 2020 lease revenue bond deal was the first bond deal done in California during an ongoing pandemic and involved a significant amount of additional disclosure work), the size of the transaction, the structure, and market conditions. All costs are approved by the Director, Finance Agency.

The report further states "… it does not appear that the County has made any attempt to reduce costs for these financial services." and "…from our review of the firm's fee proposals, as submitted in advance of each of the seven debt issuances between 2016 and 2020, the County simply approved all proposed amounts. It does not appear that the County has taken any steps to constrain the costs for the financial advisory services related to issuing debt."

The County engages in a transaction cost discussion with the municipal advisor prior to any deal. This mutually agreed-upon cost is what is reflected in the invoices from KNN. KNN does not send an initial invoice as basis for discussion – the invoice is created after the discussion. Staff have negotiated lower transaction fees for several bond transactions, especially in those instances where bond issuances were done close together. This includes the two deals done in July 2021. By scheduling the transactions close together, staff is able to lower the costs of issuance, not just from the municipal advisor but also from bond counsel and, especially, disclosure counsel because the same disclosure documents can often be used for both transactions.

An analysis of publicly available data from CDIAC on bond issuances since 2012 shows that Santa Clara County is at the median or better for the municipal advisor fee (in terms of $ per $1,000 par issued) for all three peer groups defined by the audit report in its benchmarking analysis, for transactions that are similar in nature to the County's transactions. The Administration appreciates the report describing the practices of Contra Costa County and San Francisco County as alternative models for evaluating and establishing fees related to debt issuance transaction costs, but would like to point out that the above referenced data analysis shows that the Contra Costa County average municipal advisor fee per $1,000 par issued is 24% higher than that of Santa Clara County.

The Finance Agency Director should:

Recommendation 5.1 Require all future bidders for debt issuance financial advisory services to provide schedules reflecting the range of potential transaction fees in their proposals to the County.

***Administration Response*:** Agreed.

Staff will request these, but with the caveat that it is difficult for a financial advisory firm to

provide meaningful and reliable cost estimates for future issuances, given that the transaction details are not known at the time of bidding for the contract. However, a range of estimated costs can likely be provided.

Recommendation 5.2 Ensure that the schedule for transaction costs, as provided by the successful bidders for financial advisory services, be reflected within the final terms of the contract.

***Administration Response*:** Agree, with the same caveat as in 5.1: while estimates can be reflected in the terms of the contract, the actual costs may differ from these estimates.

Debt Management Achievements

The Santa Clara County Debt Management Unit is an experienced team with numerous achievements over the years, ranging from one-time items, such as refundings, to regularly recurring items, such as annual disclosures. Below are some of the highlights from the past several years.

Refunding and Restructuring

- Completed all refunding opportunities over the past six years, resulting in net present value savings to the County of over $112 million.
- In addition to the net present value savings of over $1 million, the refunding of the variable rate 1994B bonds into 2016A fixed rate bonds eliminated future interest rate risk.
- Renewed the letter of credit with Bank of America supporting our interest rate swap for three years at a rate of 0.32%

Bonds issued in accordance with Board priorities

- 2021A Lease Revenue Bonds (Adolescent Psychiatric Facility/Behavioral Health Services Center)
    - The Board of Supervisors identified the need to improve the programs and facilities for behavioral health services. This financing provides for the construction of a new facility that addresses the limited access to child and adolescent inpatient psychiatric facilities in Santa Clara County.

- 2021B General Obligation Bonds (Affordable Housing Bonds)
    - The second series of voter approved 2016 Measure A bonds furthers the Board's priority to provide affordable local housing for vulnerable populations, including veterans, seniors, individuals with disabilities, low- and moderate-income individual or families, foster youth, victims of abuse, the homeless and individuals suffering from mental health or substance abuse illnesses.

- 2019A Lease Revenue Bonds (VMC)
    - The bonds were issued to finance the acquisition of two hospitals and health care facilities which allow the County to provide enhanced hospital and medical services to the general population of Santa Clara County.

Strong Investor Demand

The County enjoys strong investor demand for its bonds. The numerous bids received in the competitive pricing process results in low interest costs to the County. The table below shows the number of bids received for the issuances in the past four years.

Bond Issue	# of Bids Received
2021A Lease Revenue Bonds	6
2021B General Obligation	6
2020A Lease Revenue Bonds	9
2019A Lease Revenue Bonds	6
2019A-T Lease Revenue Bonds	10
2018A Lease Revenue Bonds	8
2018A Lease Revenue Bonds	9

Strong Credit Ratings

- The County has strong credit ratings. Excerpts from S&P's rating of the 2021A and 2021B bonds highlight the strong policies and fiscal management of the County:
  - "Debt management policy that goes beyond statutory requirements, including a policy for swaps, and a practice of debt reporting in annual audits"
  - "Long-term liabilities are low to moderate relative to the county's substantial resource base at about 9% of personal income"

- In December 2018 the County received unsolicited upgrades from Moody's. The rating agency upgraded the County's ratings from Aa2 to Aa1 for general obligation bonds and from A1 to Aa2 for lease revenue bonds.

Assistance to other Santa Clara County issuers of municipal debt

- FY2020-21 - Assisted with the issuance of 27 County school district General Obligation bond financings totaling almost $2 billion
- Acted as paying agent for 14 school TRANs totaling nearly $103 million
- Monitored $4.7 million in federal subsidies for various school District's Qualified School Construction Bonds (QSCB)
- Facilitated an average of five TEFRA hearings per year over the past three years.

Annual and Continuing Disclosure

- In FY2020-2021, prepared the operating data and completed the annual disclosure on the Electronic Municipal Market Access system (EMMA) for 17 outstanding debt issuances (see next page for list of debt issuances)

- Completing annual disclosure of the County's financial report to Trustees and rating agencies as well as required disclosure of County budget and insurance information to Trustees.

- Established the Continuing Disclosure Working Group in March 2016:
  - Meets annually in March or more frequently if needed
  - Membership includes representatives from Finance, County Counsel, and Disclosure Counsel
  - Reviews any material events that have occurred since the previous meeting
  - Provides update on the status of current annual disclosure filings
  - Members are notified of any changes affecting disclosure requirements and revisions to procedures

- Completion of several annual reports to the Santa Clara County Board Committees and the State of California (CDIAC), including:
  - Debt and swap report for the Finance and Government Operations Committee
  - CDIAC SB1029 report
  - CDIAC Marks-Roos report

Other Highlights

- Worked with the County's Municipal Advisor to update the debt affordability model in February 2021 to continue evaluating debt financing options for long-term capital planning.
- Monitoring of federal subsidies for the County's Qualified Energy Conservation Bonds and New Clean Renewable Energy Bonds

17 outstanding debt issuances requiring annual continuing disclosure and operating data:

1. Santa Clara County Financing Authority Lease Revenue Bonds (Fire District Facilities), 2020 Series A, $29,585,000, Dated: June 25, 2020
2. Santa Clara County Financing Authority Lease Revenue Bonds (County Facilities), 2019 Series A, $261,100,000, Dated: June 27, 2019
3. Santa Clara County Financing Authority Lease Revenue Bonds (County Facilities), 2019 Series A-T (Federally Taxable), $16,080,000, Dated: June 27, 2019
4. Santa Clara County Financing Authority Lease Revenue Bonds (County Facilities), 2018 Series A, $164,355,000, Dated: September 26, 2018
5. Santa Clara County Financing Authority Lease Revenue Bonds (VMC Refunding), 2018 Series A, $55,090,000, Dated: August 21, 2018
6. County of Santa Clara, California, General Obligation Bonds (Election of 2008), 2017 Refunding Series C (Dedicated Unlimited Ad Valorem Property Tax Bonds), $290,510,000, Dated: November 16, 2017
7. County of Santa Clara, California General Obligation Bonds (Election of 2016), (Federally Taxable) (Dedicated Unlimited Ad Valorem Property Tax Bonds), 2017 Series A, $250,000,000 Dated: November 9, 2017
8. Santa Clara County Financing Authority Lease Revenue Bonds (VMC Refunding), 2016 Series A, $41,810,000 Dated: September 20, 2016
9. Santa Clara County Financing Authority Refunding Lease Revenue Bonds (Multiple Facilities Projects) 2016 Series Q, $168,345,000 Dated: June 8, 2016
10. Santa Clara County Financing Authority Refunding Lease Revenue Bonds (Multiple Facilities Projects) 2015 Series P, $102,435,000, Dated: June 3, 2015
11. Santa Clara County Financing Authority Refunding Lease Revenue Bonds (Multiple Facilities Projects) 2014 Series O, $11,715,000, Dated: April 22, 2014
12. County of Santa Clara, California General Obligation Bonds, (Election of 2008) 2013 Series B, $490,000,000, Dated: March 6, 2013
13. Santa Clara County Financing Authority Lease Revenue Bonds (Capital Projects) 2012 Series A, $86,920,000, Dated: August 8, 2012
14. County of Santa Clara, California General Obligation Bonds, (Election of 2008) 2009 Series A, $350,000,000, Dated: May 27, 2009
15. Santa Clara County Financing Authority Variable Rate Demand Refunding Lease Revenue Bonds (Multiple Facilities Projects) 2008 Series M, $143,105,000, Dated: May 29, 2008 (No Annual Requirement)
16. County of Santa Clara, California Taxable Pension Funding Bonds, Series 2007, $389,484,822.40, Dated: July 6, 2007
17. Association of Bay Area Governments Lease Revenue Bonds, Series 2002-1 (California Capital Projects) Participants: City of Encinitas and Santa Clara County, $13,370,000, Dated: July 18, 2002

	Economic and Financial Data										
County	County Population	Net Assessed Valuation	Total General Fund Balance	"Available" General Fund Balance (Calc)	"Available" Total Governmental Fund Balance (Calc)	General Fund Available Cash	Total Government Available Cash	General Fund Expenditures	Total Governmental Funds Expenditures	General Fund Revenue	Total Governmental Fund Revenue
Alameda County	1,671	$ 313,787,670	$ 2,067,280	$ 1,636,811	$ 2,242,762	$ 2,102,080	$ 3,038,761	$ 2,659,330	$ 3,283,118	$ 2,932,698	$ 3,463,034
Contra Costa County	1,154	$ 226,009,005	$ 637,170	$ 586,571	$ 752,691	$ 630,258	$ 1,375,899	$ 1,582,872	$ 2,421,021	$ 1,728,214	$ 2,514,036
Fresno County	1,023	$ 86,787,811	$ 197,786	$ 184,393	$ 184,393	$ 91,097	$ 725,864	$ 1,572,747	$ 1,754,319	$ 574,282	$ 1,781,127
Kern County	918	$ 98,751,417	$ 328,063	$ 295,755	$ 325,912	$ 258,879	$ 716,062	$ 649,761	$ 1,750,776	$ 659,783	$ 1,748,812
Los Angeles County	10,173	$ 1,625,539,871	$ 4,518,804	$ 4,308,802	$ 4,690,378	$ 5,027,623	$ 9,695,619	$ 20,699,250	$ 24,052,814	$ 20,978,099	$ 25,198,173
Orange County	3,194	$ 632,758,256	$ 863,302	$ 324,246	$ 538,390	$ 1,137,361	$ 2,853,448	$ 3,517,729	$ 4,431,679	$ 3,352,317	$ 4,387,754
Riverside County	2,442	$ 297,392,102	$ 401,682	$ 286,505	$ 390,360	$ 308,199	$ 1,418,755	$ 3,292,692	$ 4,654,448	$ 3,280,752	$ 4,044,421
Sacramento County	1,552	$ 173,197,285	$ 434,900	$ 185,464	$ 185,464	$ 404,201	$ 824,856	$ 2,462,686	$ 3,054,391	$ 2,658,641	$ 3,114,939
San Bernardino County	2,181	$ 235,298,320	$ 1,215,943	$ 706,630	$ 1,173,308	$ 1,408,963	$ 2,808,419	$ 2,924,943	$ 3,868,944	$ 3,164,661	$ 4,008,148
San Diego County	3,343	$ 567,195,439	$ 2,468,496	$ 1,748,991	$ 1,025,926	$ 2,649,196	$ 3,240,150	$ 4,298,362	$ 5,083,670	$ 4,304,496	$ 5,148,346
San Francisco County	863	$ 279,368,184	$ 2,685,922	$ 2,455,579	$ 2,505,096	$ 3,492,112	$ 6,728,540	$ 4,433,849	$ 7,034,870	$ 5,472,952	$ 7,181,394
San Joaquin County	774	$ 80,557,041	$ 373,932	$ 274,576	$ 399,311	$ 389,293	$ 1,066,684	$ 840,748	$ 1,178,438	$ 898,120	$ 1,290,486
San Mateo County	773	$ 240,454,087	$ 1,413,617	$ 1,230,533	$ 1,382,933	$ 1,517,476	$ 1,995,994	$ 1,221,168	$ 1,463,721	$ 1,586,420	$ 1,731,922
Santa Clara County	1,962	$ 513,898,603	$ 1,065,461	$ 816,462	$ 1,429,042	$ 1,456,799	$ 2,742,122	$ 3,062,421	$ 3,787,152	$ 3,465,585	$ 4,110,792
Stanislaus County	554	$ 50,135,873	$ 223,864	$ 201,815	$ 238,839	$ 269,610	$ 497,657	$ 456,274	$ 1,208,434	$ 530,783	$ 1,234,226
Ventura County	843	$ 145,204,002	$ 505,912	$ 227,032	$ 268,877	$ 676,714	$ 1,020,325	$ 1,088,643	$ 1,484,958	$ 1,155,497	$ 1,561,404

	Economic and Financial Ratios										
County	**Assessed Valuation per Capita**	**General Fund Balance as % of General Fund Expenditures**	**General Fund Balance as % of General Fund Revenues**	**"Available" General Fund Balance as % of General Fund Expenditures**	**"Available" General Fund Balance as % of General Fund Revenues**	**General Fund Net Result (%)**	**Total Governmental Funds Net Result (%)**	**General Fund Available Cash as % of General Fund Expenditures**	**General Fund Available Cash as % of General Fund Revenues**	**Total Governmental Available Cash as % of Total Government Fund Expenditures**	**Total Governmental Available Cash as % of Total Government Fund Revenues**
Alameda County	$ 187,747	77.7%	70.5%	61.5%	55.8%	6.1%	5.0%	79.0%	71.7%	92.6%	87.7%
Contra Costa County	$ 195,923	40.3%	36.9%	37.1%	33.9%	3.0%	1.7%	39.8%	36.5%	56.8%	54.7%
Fresno County	$ 84,807	12.6%	34.4%	11.7%	32.1%	-0.4%	0.7%	5.8%	15.9%	41.4%	40.8%
Kern County	$ 107,625	50.5%	49.7%	45.5%	44.8%	0.7%	-0.2%	39.8%	39.2%	40.9%	40.9%
Los Angeles County	$ 159,790	21.8%	21.5%	20.8%	20.5%	0.4%	0.1%	24.3%	24.0%	40.3%	38.5%
Orange County	$ 198,088	24.5%	25.8%	9.2%	9.7%	2.0%	-0.9%	32.3%	33.9%	64.4%	65.0%
Riverside County	$ 121,767	12.2%	12.2%	8.7%	8.7%	-1.0%	-13.0%	9.4%	9.4%	30.5%	35.1%
Sacramento County	$ 111,596	17.7%	16.4%	7.5%	7.0%	3.1%	2.4%	16.4%	15.2%	27.0%	26.5%
San Bernardino County	$ 107,908	41.6%	38.4%	24.2%	22.3%	-1.6%	3.5%	48.2%	44.5%	72.6%	70.1%
San Diego County	$ 169,649	57.4%	57.3%	40.7%	40.6%	0.9%	0.8%	61.6%	61.5%	63.7%	62.9%
San Francisco County	$ 323,686	60.6%	49.1%	55.4%	44.9%	-0.6%	-6.3%	78.8%	63.8%	95.6%	93.7%
San Joaquin County	$ 104,128	44.5%	41.6%	32.7%	30.6%	1.8%	8.4%	46.3%	43.3%	90.5%	82.7%
San Mateo County	$ 310,968	115.8%	89.1%	100.8%	77.6%	12.8%	12.6%	124.3%	95.7%	136.4%	115.2%
Santa Clara County	$ 261,930	34.8%	30.7%	26.7%	23.6%	0.5%	1.3%	47.6%	42.0%	72.4%	66.7%
Stanislaus County	$ 90,495	49.1%	42.2%	44.2%	38.0%	0.4%	1.7%	59.1%	50.8%	41.2%	40.3%
Ventura County	$ 172,270	46.5%	43.8%	20.9%	19.6%	-0.3%	2.2%	62.2%	58.6%	68.7%	65.3%

	Debt Statistics							Debt Ratios						
County	GO Rating - Moody's	GO Rating - S&P	LRB Rating - Moody's	LRB Rating - S&P	Net Direct Debt (Par Amount Outstanding)	Overall Net Debt (Overlapping Tax & Assessment Debt)	Total Annual Debt Service	Net Direct Debt as % of AV	Overall Net Debt as a % of AV	Debt Per Capita	Net Direct Debt as % of Total Governmental Fund Revenues	Annual Debt Service as % of General Fund Revenues	Annual Debt Service as % of Total Government Funds Expenditures	Total Government Available Cash as % of Debt Service
Alameda County	Aaa	AAA	Aa1	AA+	$ 1,342,459	$ 11,064,976	$ 121,746	0.43%	3.5%	$ 803	38.8%	4.2%	3.7%	2496.0%
Contra Costa County	Aa1	AAA	Aa3	AA+	$ 348,791	$ 5,564,645	$ 87,956	0.15%	2.5%	$ 302	13.9%	5.1%	3.6%	1564.3%
Fresno County	NR	AA-	NR	AA-	$ 359,467	$ 2,582,936	$ 38,621	0.41%	3.0%	$ 351	20.2%	6.7%	2.2%	1879.5%
Kern County	Aa3	NR	A1	NR	$ 335,242	$ 2,462,378	$ 80,847	0.34%	2.5%	$ 365	19.2%	12.3%	4.6%	885.7%
Los Angeles County	Aa1	AAA	Aa2	AA+	$ 2,202,474	$ 38,967,124	$ 507,516	0.14%	2.4%	$ 217	8.7%	2.4%	2.1%	1910.4%
Orange County	Aa1	AA+	Aa2	AA	$ 625,363	$ 11,389,649	$ 133,960	0.10%	1.8%	$ 196	14.3%	4.0%	3.0%	2130.1%
Riverside County	Aa3	AA	A1	AA-	$ 2,025,861	$ 12,920,260	$ 152,727	0.68%	4.3%	$ 829	50.1%	4.7%	3.3%	928.9%
Sacramento County	A1	AA-	A2	A+	$ 1,358,722	$ 5,888,708	$ 204,703	0.78%	3.4%	$ 875	43.6%	7.7%	6.7%	403.0%
San Bernardino County	Aa1	AA+	Aa2	AA	$ 418,836	6,025,910	$ 123,753	0.18%	2.6%	$ 192	10.4%	3.9%	3.2%	2269.4%
San Diego County	Aaa	AAA	Aa1	AA+	$ 701,274	16,505,387	$ 171,305	0.12%	2.9%	$ 210	13.6%	4.0%	3.4%	1891.5%
San Francisco County	Aaa	AAA	Aa1	AA+	$ 3,968,622	$ 5,359,510	$ 447,521	1.42%	1.9%	$ 4,598	55.3%	8.2%	6.4%	1503.5%
San Joaquin County	Aa2	NR	Aa3	NR	$ 110,558		$ 8,364	0.14%	0.0%	$ 143	8.6%	0.9%	0.7%	12753.2%
San Mateo County	Aaa	AAA	Aa1	AA+	$ 574,451	$ 5,319,952	$ 58,499	0.24%	2.2%	$ 743	33.2%	3.7%	4.0%	3412.0%
Santa Clara County	Aa1	AAA	Aa1	AA+	$ 2,553,500	$ 15,028,126	$ 181,534	0.50%	2.9%	$ 1,301	62.1%	5.2%	4.8%	1510.5%
Stanislaus County	A1	AA-	NR	A+	$ 135,587		$ 6,294	0.27%	0.0%	$ 245	11.0%	1.2%	0.5%	7907.1%
Ventura County	Aaa	AAA	Aa1	AA+	$ 397,230		$ 16,908	0.27%	0.0%	$ 471	25.4%	1.5%	1.1%	6034.6%

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County of Butte Debt Management Guidelines and Procedures

COUNTY OF BUTTE
DEBT MANAGEMENT GUIDELINES AND PROCEDURES
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OBJECTIVES

The objective of the Debt Management Guidelines and Procedures (DMGP) is to establish a method to address long-term capital improvement costs, short-term and long-term cash management strategies, the creation of guidelines and procedures that minimize Butte County's (County) debt service and issuance costs, provide for the highest practical credit rating, and maintain full and complete financial disclosure and reporting.

The County's overriding goal in incurring long-term financial obligations is to respond to the evolving needs of its citizens while maintaining its fiscal responsibilities. The DMGP documents the County's goals for the use of debt instruments and provides guidelines for the use of debt for financing County needs.

An important goal of the DMGP is to maximize the County's credit ratings when issued by the primary bond rating agencies Fitch, Moody's and Standard and Poor's. By maintaining the highest practicable credit rating, the County can issue its debt at lower interest rates than entities with lower ratings.

The County will also seek to minimize borrowing costs by taking advantage of favorable economic conditions. Timing debt issuance to accommodate market interest rates and investor sentiment is an important means of minimizing the cost of debt and the tax burden on the citizens of Butte County. To accomplish this, the County will seek input on market conditions from financial consultants who closely monitor the financial markets.

The debt policies and practices of the County are, in every case, subject to and limited by applicable provisions of California ("State") and federal law. The County will adhere to the following legal requirements for the issuance of public debt:

- State law which authorizes the issuance of the debt
- Federal and State tax laws which govern the eligibility of the debt for tax-exempt status
- Federal and State securities laws governing disclosure, sale and trading of the debt

The term "Bonds," as used in the DMGP, refer to a class of debt instruments that may have fixed, variable or floating interest rates, with terms of repayment from 90 days to 30 or 40 years, and provide a means for local government to finance projects and activities.

DEBT ADVISORY COMMITTEE

All debt issuance proposals, once analyzed and approved for escalation, are to be communicated to and reviewed by the Debt Advisory Committee (Committee). Each debt issuance proposal will be evaluated by comparing it with competing proposals on the basis of the benefits derived, the prioritized needs of the County, and limits of debt that can be prudently and legally absorbed. If the debt issuance requires voter approval, that process begins after the Board of Supervisors (Board) has given their approval for the debt issuance.

A. Committee Structure

The Committee shall have four (4) members:

- Chief Administrative Officer (Chair)
- County Treasurer (Vice-Chair)
- Budget Director
- County Auditor-Controller

County Counsel, or his/her designee, as needed, will act as the Committee's legal counsel and provide legal advice. The CAO is responsible for setting and distributing the agenda and chairing the meetings.

B. Committee Purpose

The Committee shall:

- Review all financing requests to determine if they comply with the DMGP and justify any recommended exceptions
- Certify the DMGP was followed, if applicable. The Committee's certification of compliance with the DMGP will be presented to the Board by the Chief Administrative Officer (CAO).

No act of the Committee shall be valid unless at least three (3) of the members concur and at least three (3) members are in attendance.

C. Meetings

Regular meetings shall be held at least annually and may be scheduled more often, as needed. Any scheduled meeting may be cancelled or re-scheduled by the Chair or, in his/her absence, the Vice-Chair.

D. Debt Review

Each proposed financing brought before the Committee will include a feasibility study that provides the following information on a "Proposed Financing" form (see Appendix A):

- A detailed description of the type and structure of the financing
- Full disclosure of the specific use of the proceeds and justification for borrowing as opposed to "pay-as-you-go"
- A description of the public benefit to be provided by the project or proposal
- The principal parties involved in the transaction
- Anticipated sources of repayment
- An estimated sources and uses statement
- Any credit enhancements proposed
- The anticipated debt rating, if any
- An estimated debt service schedule and how it compares to the asset life
- An analysis of the County's debt ratios after the completion of the financing, pursuant to established guidelines
- An analysis demonstrating the completed project can be supported with ongoing cash flow

Revisions to the DMGP may be appropriate from time to time to address changing financial goals, emerging financial products and debt structures, and unique market opportunities.

Exceptions and/or revisions to the DMGP can be made by the CAO, as necessary to keep aligned with industry best practices, and will be approved by the Board.

AUTHORITY AND RESPONSIBILITY

The CAO, with approval of the Board and as required by law, will coordinate the issuance of all long-term debt (debt with a final maturity of greater than thirteen (13) months) including issuance size, debt structuring, pledging of repayment sources, securing the professional services that are required to develop and implement the County's long-term debt program, and the method of sale. Relative to the County's long-term debt, the CAO shall be responsible for providing authorization to secure the services of one or more major credit rating agencies, maintaining relationships with the rating agencies that assign ratings to the County's various debt obligations, and for the filing and accuracy of disclosures and other bond related documents.

The Treasurer, with approval of the Board and in cooperation with the CAO and Auditor-Controller, will coordinate the issuance of all short-term debt (debt with a term of thirteen (13) months or less) including issuance size, debt structuring, pledging of repayment sources, selection of the financing team, including an underwriter or underwriting syndicate, and the method of sale. Relative to the County's short-term debt, the Treasurer shall also be responsible for providing authorization to secure the services of one or more major credit rating agencies, maintaining relationships with the rating agencies that assign ratings to the County's short-term debt obligations, and for the filing and accuracy of disclosures and other bond related documents.

The Auditor-Controller is responsible for providing accurate, audited financial statements and cash flow analysis used as a basis for disclosure.

County Counsel and the financing team will manage any legal activities that may arise with respect to issuance of the bonds. In circumstances where there may be legal uncertainty about some aspect of a proposed bond transaction, the County may pursue a validation action to obtain judicial approval before the bonds are issued to avoid a situation where a bond transaction is controversial and gives rise to a reverse validation action and possible litigation.

Should this or any other material situation arise, the Committee and/or the Board will be informed of action taken.

CREDIT ISSUANCE GUIDELINES

Although long-term financing usually requires higher total expenditures than a cash purchase, it has the benefit of allowing immediate completion of the project so those paying for the project are also those utilizing the project. Additionally, during times of rapidly increasing construction costs, the costs related to financing a project are sometimes less than construction cost increases caused by delaying the project until adequate cash is available.

The County will conform to State statutes, federal tax and securities regulations and the County Charter and will issue debt at levels consistent with its creditworthiness objectives. The County shall use an objective, analytical approach to determine whether it can afford to assume the new debt.

When analyzing the appropriateness of a debt issuance, the County shall compare generally accepted measures of affordability to the current property values for the County. These measures shall include, but not be limited to:

- Net Direct Debt as a Percentage of the Assessed Valuation: This is the outstanding principal of direct net debt, as of the end of the most recently ended fiscal year, as a percentage of the assessed valuation
- Net Direct Debt as a Percentage of Operating Revenues: This is the outstanding net direct debt, as of the end of the most recently ended fiscal year, as a percentage of operating revenues
- Total Governmental Funds Debt Service as a Percentage of Total Governmental Funds Expenditures: This is the annual debt service (principal and interest), as of the end of the most recently ended fiscal year, as a percentage of expenditures.

Net Direct Debt is the County's gross debt (including notes, loans, and capital leases) minus debt supported entirely by specific user fees.

Credit rating agencies assign a credit rating to a bond issue based upon an independent appraisal of the credit quality and likelihood of timely repayment. Generally, the credit rating is the most important factor in determining the interest rate on bonds. A review of recent credit rating agency guidelines indicated the County should strive to maintain these debt ratios at the following levels:

• Net Direct Debt/Property Valuations	2% or less
• Net Direct Debt/Operating Revenues	Less than 67%
• Total Governmental Funds Debt Service/Total Governmental Expenditures	Less than 5%

In assessing affordability, the County shall also examine the direct costs and benefits of the proposed project. The decision of whether or not to assume new debt shall be based on these costs and benefits, current conditions of the municipal bond market, and the County's ability to "afford" new debt as determined by the aforementioned measurements.

CAPITAL PLANNING AND FINANCING SYSTEM FOR LONG-TERM DEBT

The capital planning process will prioritize projects and identify the funding needs, as the aggregate cost of desired capital projects generally exceeds available funds. Whenever possible, the County shall pursue “pay-as-you-go," including impact fees, special assessments, self-supporting revenue or grant funding, instead of general fund obligated debt. The debt management process will determine the availability of funds which can be raised legally and effectively through debt issuance, the totality of projects that can be accomplished, and when the projects will commence. Close coordination of capital planning and debt management will ensure that County citizens achieve maximum benefit from available capital funds and that the potential for inappropriate or avoidable spending will be minimized. This coordinated program will be referred to as the Capital Improvement Program (CIP).

The County shall maintain a system for analyzing and preparing a multi-year CIP, which will be considered and adopted by the Board concurrent with or in close proximity to the County's annual budget process. The CIP will focus on capital expenditures for facilities, roads and bridges.

The CIP shall contain comprehensive descriptions of each project, including funding sources and timing. The CIP shall ensure planned financings conform to the DMGP targets regarding:

- Magnitude and composition of the County's indebtedness
- Economic and fiscal resources of the County to bear such indebtedness

Affordability impacts of the CIP shall be evaluated in consultation with the various County departments. Such planning will consider a long-term needs approach so project priorities and future commitments of funds are clearly visible, providing a basis for management decisions and public comment.

A. Maintenance, Replacement and Renewal

Consistent with a philosophy of keeping its capital facilities and infrastructure systems in good repair and to maximize the useful life of capital assets, the County should set aside sufficient current revenues to finance ongoing maintenance needs and to provide reserves for periodic replacement and renewal.

B. Asset Life

The County will consider long-term financing for the acquisition, maintenance, replacement, or expansion of physical assets (including land) only if they have a useful life of at least five years. County debt will not be issued for periods exceeding the useful life or average useful lives of the project or projects to be financed.

C. Competing Projects

Competing projects requiring funds will be evaluated according to priorities established by the Board. The selection of projects will consider the projects' abilities to meet the County's priorities and the financial requirements of the projects. For each project, the following information is necessary to assess the feasibility of the project and its funding with long-term debt:

1. Nature of Project and Use of Funds

The scope and nature of the project, as well as the intended use of the debt proceeds, will be described.

2. Cost-Benefit Analysis of Project

The CAO will ensure a cost-benefit analysis is conducted for each proposed project financing. The benefits of a proposed project will be defined and, where appropriate, quantified in monetary terms. The sources and uses of funds will be identified and estimated. Where revenues are part of the benefits, all assumptions made in deriving the revenues will be documented. The validity of the assumptions and the risk associated with the revenue streams will be assessed. The costs of the project will be estimated, with the basis of estimates documented and the risk associated with the estimates assessed.

The County will not assume tax-supported general-purpose debt without an objective analysis as to the community's ability to assume and support additional debt payments and operational costs.

If general fund debt, as opposed to general obligation bonds (GO bonds) is proposed, the CAO will identify the repayment sources and evaluate continued repayment ability over the term of the loan.

3. Expenditure Plan and Sources of Debt Servicing

The CAO will ensure a detailed expenditure and repayment plan is developed for each project. The plan will include total estimated project costs, project funding sources, and debt service estimates and repayment sources. The plan will demonstrate timely matching of available funds to project expenditures and commencement of scheduled debt service. The basis of estimates for the project cost expenditure plan and any supporting revenue cash flow estimates will be documented and the risk associated with such revenue streams will be analyzed.

TYPES AND PURPOSES OF DEBT

The County may issue debt for either new money or refunding (refinancing) purposes; however, long-term debt shall never be used to fund operating costs. There are many different types of financing instruments available. The financing instrument(s) used by the County depend(s) on legal constraints, investor demand, capital market activity and the type of project being financed.

Long-term debt is preferred for financing essential capital activities, including the acquisition, construction and rehabilitation of major capital assets, but may also be used to fund other liabilities such as self-insurance, workers' compensation insurance and unfunded pension or benefit liability.

The County may issue GO bonds, which are bonds secured by a promise to levy taxes in an unlimited amount as necessary to pay debt service. Debt service on the bonds is provided from *ad valorem* taxes on real property within the County. Under Section 1(b)(2) of Article XIIIA of the State Constitution, any new indebtedness to be repaid from an *ad valorem* tax levied against real property must be approved by a two-thirds majority of those voting on the bond proposition. However, under Section 1(b)(3) of Article XIIIA of the State Constitution, school districts may authorize GO bonds if the bonds are approved by 55% of those voting on the proposition. Bonds issued under this provision have statutory maximum aggregate ad valorem tax rates specified (by type of school issuer).

While GO bonds typically are the least expensive debt available to government entities (tax supported bonds are considered to be a lower risk), drawbacks include:

- Forecasting tax revenues for budgeted debt service can be difficult since property values can stagnate or fluctuate over the loan term
- Two-thirds voter approval (55% in the case of school bonds) is difficult to obtain
- The election process may be too time intensive and costly to pursue
- The use of GO funds is limited to real property acquisitions or improvements, potentially resulting in the need for additional financing to acquire necessary equipment and furniture for the property

The County may also use long-term lease obligations to finance or refinance capital equipment or facilities. Prior to entering into any lease financing, the County will evaluate 1) the useful life of assets financed, 2) terms and conditions of the lease and 3) budgetary, debt capacity and tax implications.

The County may issue Certificates of Participation (COPs) to finance the acquisition of equipment or construction of a facility. COPs are a form of lease obligation in which the County enters into an agreement to pay a fixed amount annually to a third party, usually a nonprofit agency or a private leasing company. Because they do not constitute indebtedness under the State constitutional debt limitation, COPs do not require voter approval and do not count towards a jurisdiction's debt volume limitations. Payments are subject to annual appropriations.

The County may use short-term obligations as a cash management tool to provide interim financing, to bridge temporary cash flow deficits within a fiscal year, and/or to reduce or hedge interest rate costs.

The County may issue Tax and Revenue Anticipation Notes (TRANs), which are short-term notes issued, in part, to finance the County's operating (General Fund) cash flow requirements during the fiscal year. Voter approval is not required. The proceeds from the sale of TRANs allow the County to cover periods of cash shortfalls resulting from a mismatch between the

timing of revenues and the timing of expenditures. County expenditures tend to occur in relatively level amounts throughout the year while receipts follow an uneven pattern. Tax payments and other revenues are used to secure TRANs. TRANs proceeds may be used for any purpose, including current operating expenses, capital expenditures, repayment of indebtedness, investment and reinvestment. Pursuant to California Government Code Section 53821, the Treasurer and Auditor-Controller are responsible for making a recommendation to the CAO and Board for the issuance of TRANs.

Before issuing TRANs, cash flow projections will be prepared by the Auditor-Controller and reviewed by the Treasurer. The timing of the borrowing, the due date of the notes, and the timing, segregation, and mechanisms of funds for repayment will be components of the cash flow and cash management analysis performed by the County.

Below are brief descriptions of many of the financing options not discussed elsewhere in the DMGP:

Bond Anticipation Notes

Where their use is judged to be prudent and advantageous, the County may choose to issue Bond Anticipation Notes as a source of short-term, interim construction financing. Before issuing such notes, takeout financing must be planned for and determined to be feasible (takeout financing is long-term financing replacing the short-term construction loan).

Joint Venture Arrangements with Other Governmental Agencies

When a project serves the public interest beyond County boundaries, the County seeks out joint arrangements where other governmental bodies share the debt burden. Joint venture debt is repaid through revenues generated by the project. The County will only be liable for its share of debt service, as specified by contract. All capital requests will explore the interaction and funding potential with other government agencies. If potential

does exist, then the possibility for grants or cost sharing will be explored, quantified and specific financial arrangements and liabilities negotiated.

Lines of Credit

Where its use is judged by the Committee to be prudent and advantageous to the County, the County has the power to enter into agreements with commercial banks or other financial entities for purposes of acquiring lines of credit that shall provide the County with access to credit under terms and conditions as specified. Before entering into any such agreements, takeout financing or other repayment sources for the lines of credit must be planned for and determined to be feasible.

Mello-Roos Bonds

Pursuant to law, the Board is authorized to establish a Community Facilities District (CFD), also known as a Mello-Roos District, and act as the legislative body for the proposed district. CFDs may be established to finance either public capital facilities or public services or both. Upon approval by two-thirds of the qualified electors within the district, the County may issue bonds and levy and collect a special tax within such district to repay the indebtedness.

Revenue Bonds

Revenue bonds may be issued by enterprises to finance capital projects. The enterprises do not have taxing authority but may sell bonds which are repaid through restricted revenues and user fees. When appropriate, self-supporting revenue bonds shall be issued before general obligation bonds. The revenues generated must be sufficient to cover the debt repayment and interest. As a planning target, estimated revenue will be required to be maintained at 150% of the maximum annual debt service. The County will make annual adjustments to any rate structure relating to revenues pledged to a bond issue, if necessary, to maintain a 150% coverage factor. The revenue bonds will not be secured by any pledge of ad valorem taxes. When capital projects are

financed by issuing revenue bonds, the term of the bonds will not exceed the expected life of those projects. The issuance of revenue bonds requires Board approval, but does not require voter approval.

Special Assessment Bonds

Special Assessment Districts are legally designated geographic areas located within the County, which, through the consent of the affected property owners, pay for basic infrastructure and public improvement to the area through a supplemental assessment. Bonds issued for financing projects of the district are repaid by special assessments of the property owners. This financing approach achieves the objective of tying the repayment of debt to those property owners who directly benefit from the improvements financed.

Term Bonds, Serial Bonds, and Capital Appreciation Bonds (CABs)

Term bonds are those where all bonds, or a portion of the issue equal to that which would mature over a period of two or more years in a bond issuance, mature at a single time. Term bonds can be structured so that a portion of term maturity is mandated to be called or retired each year (called sinking reserves) to mirror a serial bond structure. The funds paid into the sinking reserves each year may be used at that time to retire a portion of the term bonds ahead of their scheduled redemption. Sinking reserves are preferred by investors since these funds provide the security of knowing that the issuer appropriately budgets and accounts for its expected future payments. Sinking reserves also ensure that the payment of funds at maturity does not overtax the issuer's resources at that time.

Serial bonds are bonds maturing annually (or serially) in specified amounts. CABs, also known as "zero-coupon bonds," are deeply discounted bonds that pay investors the face value of the bonds upon maturity. CABs will be utilized in certain cases to better manage a project's cash flow to the bond's debt service.

The decision to use term, serial, or CABs is typically driven by bond marketing conditions. Specifically, if there is strong demand or weak demand for a particular bond maturity, the underwriter may combine two or more years of serial maturities as a term bond to take advantage of the strong demand or avoid the weak demand.

METHODS OF ISSUANCE AND SALE

A. Methods of Sale

1. Long-Term Debt

Long-term debt issues are sold to an underwriter or underwriting syndicate either through a public offering or a private offering. An underwriter or underwriting syndicate purchases bonds from an issuer with the intent to resell the bonds to investors. An underwriting syndicate is a firm or a group of firms that will purchase all of the bonds from the issuer and sell them to investors. For all negotiated sales, underwriters will be required to demonstrate sufficient capitalization and experience related to the debt issuance being proposed. The following criteria will be considered in selecting an underwriter: Overall experience as a managing or co-managing underwriter; marketing philosophy and distribution; capability of marketing or underwriting bonds; satisfactory performance as underwriter for previous County financing(s); financial strength, as evidenced by the firm's current financial statement; experience of the public finance team assigned to the financing; resources to complete the financing; and the total overall cost and breakdown of the underwriter's discount. The selection of underwriters may be for an individual or series of financings or a specified time period. The selected method of sale will be that which is the most advantageous to the County, as determined by the CAO, in consultation with the Committee, in terms of lowest borrowing costs, net interest rate, most favorable terms in the financial structure used, market conditions, and/or prior experience. The Board must approve the process selected prior to the sale.

Public Offerings - Public Offerings can be executed through either a negotiated sale or a competitive sale.

a. Negotiated Sale

A negotiated sale is a sale of bonds whereby the terms and price are negotiated by the County through an exclusive agreement with a previously selected underwriter and/or underwriting syndicate. In many cases, County debt is issued via a negotiated process, which provides the County control over the financing structure, the issuance timing and flexibility of distribution. In addition, competitive bidding on bond pricing may be included within the negotiated terms.

b. Competitive Sale

In a competitive sale, competing underwriters deliver sealed bids to the County, at the time and place specified in the official notice of sale. The County selects the underwriter offering the best terms at the time. Bids will be awarded on a True Interest Cost (TIC) basis, providing other bidding requirements are satisfied. TIC is a method of calculating bids for new issues that takes into consideration certain costs of issuance and the value of money. In such instances where the CAO deems the bids received unsatisfactory, the CAO may enter into negotiations for sale of the securities or reject all bids. The notice of sale will be carefully constructed to ensure the best possible bid for the bonds, in light of existing market conditions and other prevailing factors.

Private Placement - When determined appropriate by the CAO, and recommended by the Committee, financing terms for specific borrowings may be negotiated directly with banks, financial institutions and federal

government agencies such as the United States Department of Agriculture Office of Rural Development. Typically, such private offerings are carried out by the County to avoid the costs of a public offering; therefore, reducing the costs of borrowing. Lease or Lease/Purchase arrangements are a typical venue for private placement.

2. Short-Term Debt

a. Underwriter Selection

The Treasurer may select an underwriter through a negotiated arrangement determined to be advantageous to the County in the current market environment or through a competitive bidding process. It is typical that a negotiated sale will, however, use a competitive bid process when the notes go to market, thereby providing the lowest available pricing on a competitive basis.

b. Private Placement

Upon consideration of market conditions, and after recommendation by the Committee, the Treasurer may determine it is in the best interest of the County to negotiate directly with a bank or other financial institution for placement of a short-term note, such as TRANs.

B. Official Statement Disclosure Requirements

All debt issues will meet the disclosure requirements of the Securities and Exchange Commission (SEC) and other government agencies before and after the bond sales take place. The purpose of the SEC requirements is to deter fraud and manipulation in the municipal securities market. The disclosure documents, particularly the Official Statement (OS), in the case of Competitive and Negotiated Sales, will provide the potential investor with full and accurate information necessary to make prudent investment decisions. An OS is not provided when long-term debt issues are sold through private placement(s). Information in the OS generally includes the County government description, comprehensive annual financial data,

tax base, current debt burden, history of tax collections, bond repayment, future borrowing plans, the source of funds for the proposed debt repayment and information specific to the bond issue. County Counsel is responsible for ensuring the disclosure of any material litigation or issues that may impact the County's fiscal condition or ability to repay debt. The Auditor-Controller, CAO, and Treasurer are responsible for validating the accuracy and completeness of financial disclosures.

SELECTION OF FINANCIAL CONSULTANTS AND SERVICE PROVIDERS

One of the first decisions to be made by the CAO and the Treasurer, in consultation with the Committee, is the selection of the initial members of the debt financing team, including bond counsel, a financial advisor and underwriter. The nature of the team members may depend upon several factors, including the type of debt being issued and procedural requirements for the type of debt.

Any consultant or service provider contracting with the County must meet the County's contract and insurance requirements. The County will maintain professional service agreements with qualified professionals related to the issuance and management of debt, including, but not limited to: bond counsel, disclosure counsel, underwriter's counsel, financial advisor(s), underwriter(s), trustee and paying agent, credit rating agencies, escrow agent, printer, insurer, and arbitrage and rebate tax consultant.

1. Bond Counsel

External bond counsel shall be retained for debt issues when required by a lender or when a written opinion affirming the County is authorized to issue the debt, stating the County has met all State constitutional and statutory requirements necessary for issuance, and determining the debt's federal income tax status is required for the financing. Bond counsel will prepare the necessary authorizing resolutions, agreements and other documents necessary to execute the financing.

2. Underwriter's Counsel

If the financing is to be sold on a negotiated basis, an underwriter's counsel will be retained. Underwriter's counsel's primary responsibility is to provide legal advice to the underwriter, prepare the purchase contract, the Preliminary Official Statement (POS) and the OS. Generally, the underwriter's counsel will also serve as the disclosure counsel and may also serve as bond counsel. Payments for underwriter's counsel will be authorized on a case-by-case basis, depending on the nature and complexity of the transaction and the needs expressed by the underwriter.

3. Financial Advisor

A financial advisor shall be selected for all public offering debt transactions to be sold on a competitive or negotiated basis. The County may select a financial advisor for private placement debt transactions. The primary responsibilities of the financial advisor are to advise and assist on the structuring, call provision options, rating and issuance of debt, timing of issuance, and generally act as an independent financial consultant and economic market expert.

4. Trustee and Paying Agent

The CAO and the Treasurer shall periodically solicit for trustee and paying agent services from qualified commercial and trustee banks. The trustee and paying agent will be selected based on the cost of providing such services, along with other qualitative measurements. The CAO or Treasurer, as appropriate, shall recommend the trustee, paying agent, and the terms of the agreements to the Committee. The trustee/paying agent is responsible for carrying out the administrative functions that are required under the bond documents. These functions include, but are not limited to, establishing the accounts and holding the funds relating to bond issues, maintaining a list of the bondholders, and paying principle and interest on the debt.

Compensation for bond counsel, underwriter's counsel, financial advisors and other financial service providers will be as low as possible, given desired qualification levels, and consistent

with industry standards. All costs and fees related to issuance of bonds will be paid out of bond proceeds.

TERM AND STRUCTURE OF COUNTY LONG-TERM DEBT

A. Term of Debt

Debt will be structured for the shortest period possible, consistent with a fair allocation of costs to current and future beneficiaries or users, in order to achieve the lowest possible net cost and recapture credit capacity for future use.

B. Debt Service Schedules

The CAO will seek to structure debt with aggregate level principal and interest payments over the life of the debt. Backloading of debt service or use of CABs (delaying repayment of principal until the end of the financing term) will be considered only when:

- The benefits derived from the debt issuance can clearly be demonstrated to be greater in the future than in the present
- Such structuring is beneficial to the County's aggregate overall amortization schedule
- Such structuring will allow debt service to more closely match revenues during the early years of the project's operation
- The structure has been fully considered and recommended for approval by the Debt Advisory Committee and the financial impact is fully disclosed to the Board of Supervisors

C. Use of Variable-Rate Securities

When appropriate, the Committee may recommend Board approval to issue securities that pay a rate of interest that varies according to a predetermined formula or results from a periodic remarketing of the securities.

D. Debt Limitations

The CAO will ensure outstanding debt remains within the limits prescribed by State statute and at levels consistent with its creditworthiness, best practices, needs and affordability objectives. Long-term obligations payable solely from specific pledged sources, in general, are not subject to a debt limitation. Examples of non-restrictive debt are the financing or refinancing of projects by the issuance of debt instruments payable from restricted revenues or user fees (Enterprise Funds), revenues generated from a project, or special assessment districts. In addition, these long-term obligations do not constitute obligations with a claim against any other resources of the government, if the pledged sources are insufficient.

E. Debt Service Reserves

In situations where there is significant uncertainty about expected revenues, or if required by the underwriter, the CAO, upon Committee recommendation and Board approval, will increase the sizing of the bond issue to provide for the funding of a debt service reserve. The reserve is available to the trustee to make principal and interest payments to bondholders in the event other available funds are insufficient to do so and are often required as part of the financing structure. Alternatively, the purchase of a surety bond in lieu of a debt service reserve fund may be considered if it results in a lower overall cost to the County. GO bonds generally do not require a reserve fund.

CREDIT RATINGS

The County seeks to maintain the highest possible credit ratings for all categories of short and long-term obligations that can be achieved without compromising delivery of basic County services and achievement of County DMGP objectives. The County recognizes that external economic, natural, or other events may from time to time affect the creditworthiness of its debt. Nevertheless, the County is committed to ensuring that actions within its control are prudent. Accordingly, each proposal for additional debt will be analyzed for its impact on the County's credit rating.

The County's minimum rating requirement for its direct debt obligations is a rating of "investment grade" or higher. If such a debt obligation cannot meet this requirement, based on its underlying credit strength, then credit enhancement may be sought to ensure that an appropriate rating is achieved. Obligations whose ratings would fall below the minimum rating requirement may be issued without a rating if credit enhancement is unavailable or the CAO, in consultation with the Committee, determines the benefit of credit enhancement is not cost effective. A lower rating standard may be accepted for indirect or conduit obligations, subject to the approval of the CAO.

The financing team will assess the probable rating of the proposed debt before its issuance. There are various considerations in determining the County's credit rating and its effect on pricing in the current municipal bond market. These include economic conditions related to the stability and reliability of sources for debt repayment, the County's reserve levels, debt history, current debt structure, the history of fiscal responsibility, and the County's management capabilities.

The use of credit enhancement may be considered if it reduces the overall costs of the proposed financing. For example, a Letter of Credit may be secured from a major bank to enhance the credit rating. This letter is an unconditional pledge of the bank's credit to guarantee principal and interest payments for a specific debt issuance, should the County be unable to meet its debt service obligation. Bond insurance is also a potential means of enhancing the bond's credit rating or marketability. However, both of these credit enhancement methods represent an added cost in terms of the bank's fee or the insurer's premium and must be evaluated.

INVESTMENT OF BOND PROCEEDS

The proceeds from the sale of bonds will be invested until used for the intended project in order to maximize utilization of public funds. The investments will be carefully placed to obtain the highest level of safety. The Butte County Treasurer's Statement of Investment Policy and the bond indentures and/or trust agreements should be referred to for more details on objectives and criteria for investment of bond proceeds. Bond proceeds will be invested, at fair market

value, by the Treasurer in a manner that minimizes any potential negative arbitrage over the life of the debt issue. Bond documents should be carefully reviewed to ensure both the Local Agency Investment Fund (LAIF) and the Butte County Pooled Investment Portfolio are approved investments. Investments held by trustees shall be disclosed in the Treasurer's Investment Report. Documentation pertaining to all investments of bond proceeds will be maintained by the Treasurer and periodically provided to the CAO, who is responsible for reporting arbitrage and rebate compliance notices to trustees and/or the Internal Revenue Service, as delineated in the financing documents.

REFUNDING LONG-TERM DEBT

A. Call Options

The CAO will determine the call option, if any, the call protection period, and the call premium for each bond sale. A call option or optional redemption provision gives the County the right to prepay or retire debt prior to its stated maturity. This option may permit the County to achieve interest savings in the future through refunding of the bonds. Often the County must pay a higher interest rate as compensation to the buyer for the risk of having bonds called in the future. In addition, if a bond or debt is called, the holder may be entitled to a premium payment ("call premium"). Because the cost of call options can vary widely, depending largely on market conditions, an evaluation of factors such as the following will be conducted in connection with each issue:

- The call premium
- Level of rates relative to historical standards
- The time until the bonds may be called at a premium or at par
- The need for original issue discounts
- The recommendation of the Committee

B. Current and Advance Refunding

As defined for federal tax law purposes, the County may issue current or advance refunding bonds when advantageous, legally permissible, prudent, and when aggregate net present value savings (expressed as a percentage of the par amount of the refunding bonds) equal or exceed 3%. Refundings of current debt shall be made only if recommended by the CAO and the Committee, and approved by the Board. Refundings with negative savings will not be considered, unless there is a compelling public policy objective.

Periodic review of all outstanding debt will be undertaken to determine refunding opportunities. Within federal tax law constraints, a refunding will be considered if and when there is a net economic benefit or if it is imperative in order to modernize covenants essential to operations and management. A current refunding provides that all proceeds (aside from expenses and reserve fund, if required) are used to extinguish existing debt at a savings to the County in the overall repayment costs. Managers of existing projects may request refundings for the purpose of taking advantage of more favorable economic conditions and lower market interest rates, restructuring the principal and debt service payments, or eliminating burdensome covenants with bondholders. Advance refundings are used to refinance outstanding debt before the date the outstanding debt becomes due or callable. Proceeds of advance refunding bonds are placed into an escrow account with a fiduciary agent and used to pay interest and principal on the refunded bonds until final redemption at their maturity or call date.

The financial advantages of a refunding must outweigh the costs and risks of reissuing bonds. The request for refunding will be assessed with competing new capital projects requiring financing. In no event will the maturity date of the refunding issue exceed the original maturity date of the refunded debt.

Savings requirements for current or advance refunding undertaken to restructure debt may be waived at the recommendation of the CAO, in consultation with the Committee, with Board approval, upon a finding that such a restructuring is in the County's overall best financial interest.

C. Refunding Escrows

The County may seek to purchase State and Local Government Securities (SLGS) to fund its refunding escrows. At the direction of the CAO and Treasurer, the County may choose to fund an escrow through the purchase of treasury securities on the open market when market conditions make such an option financially preferred. The Treasurer shall be responsible for developing procedures for executing open market purchases and the savings objectives to be achieved by undertaking such actions.

DERIVATIVES & CONDUIT FINANCINGS

A. Derivative Products

The County may choose to enter into contracts and financing agreements involving interest rate swaps (contracts that allow a debt issuer to "swap" the interest rate it currently pays on an outstanding debt issue), floating/fixed rate auction or reset securities, or other forms of debt bearing synthetically determined interest rates as authorized under the applicable statutes. The County will consider the use of derivative products on a case-by-case basis and consistent with State statute and financial prudence.

Prior to considering any derivative agreement, a separate derivatives policy will be established by the CAO, in collaboration with the Committee, and approved by the Board. Before entering into such contracts or agreements, the CAO will review the risks and benefits of such financing techniques and the expected impacts on the County's long-term financial operations and credit ratings. The completed report shall be presented to the Committee for review before any recommendations are submitted to the Board for authorization and implementation.

B. Conduit Financings

Conduit financing is a financing in which the proceeds of the issue are loaned to a non-governmental borrower who then applies the proceeds for a project financing or, if permitted by federal tax law for a qualified 501(c)(3) bond for working capital purposes. The County may sponsor conduit financings for those activities (i.e., economic development, housing, health

facilities, etc.) that have a general public purpose and are consistent with the County's overall service and policy objectives. All such conduit financings must insulate the County completely from any credit risk or exposure and must first be approved by the CAO before being submitted to the Board for authorization and implementation. Separate guidelines and procedures will be established for public finance pertaining to the use of the Mello-Roos Community Facilities Act of 1982, the 1911, 1913 or 1915 Acts, the Landscaping and Lighting Act of 1972 or any other Act pertaining to the use of Land-Based Financing Districts, as a conduit financing mechanism.

GO Bonds, TRANs and other debt issued by School Districts and the Board of Education under the Education Code require that the Board adopt a resolution to issue the debt on behalf of the schools. This type of conduit financing is managed by the Treasurer, who invests the bond proceeds on behalf of the schools and who may also serve as trustee or paying agent for the schools' short-term debt issuance. The Treasurer is responsible for ensuring that initial disclosure of related County information for the Official Statement for each debt issuance is provided timely and accurately. The Treasurer remains responsible for ensuring continuing disclosure requirements are met annually for debt issued by the Board of Supervisors on behalf of a school district after January 1, 2017, in accordance with the provisions of SB1029; bonds issued prior to January 1, 2017 place the responsibility for continuing disclosure with the school district. Arbitrage/rebate reporting requirements on such debt issues are the responsibility of the issuer; however, care must be taken to ensure that investment parameters, as established in the bond documents, are adhered to and that arbitrage and rebate legal restrictions are met, including periodic reporting of interest earnings to the school issuing the debt.

School Districts also have the authority under Government Code to directly issue GO Debt with the approval of the Board of Supervisors. The analysis and recommendation for approval of direct issuance is the responsibility of the Treasurer and requires scrutiny of the proposed debt structure and the bond documents.

The Auditor-Controller is responsible for annually establishing the ad valorem tax rate for each GO bond issue and maintaining records and communications with the school districts and trustees pertaining to debt service payments.

When analyzing a proposed conduit financing, the County shall consider the borrower's creditworthiness, including a minimum credit rating, the purpose of the borrowing issue, the appropriateness of the debt structure and overall cost of repayment, and the impact the financing could have on the Overall Debt applicable to the County as a percentage of the County's total assessed value. Such limitations reflect sound public policy, particularly if there is a contingent impact on the general revenues of the County or the marketability of the County's own direct debt.

Overall Debt is comprised of the County's direct debt burden and the debt levels of underlying and overlapping entities such as school districts, college districts, and cities within the County. The County's proportional share of the debt of other local governmental units which overlap it or underlie it is called the overlapping debt. Overlapping debt is generally apportioned based upon relative assessed value. While the County does not control debt issuance by other entities, it recognizes that its taxpayers share the overall debt burden.

A review of recent credit rating agency guidelines indicated the County should strive to maintain the Overall Debt as a Percentage of the Assessed Valuation below ten percent (10%), while acknowledging a ratio of less than three percent (3%) has a favorable effect on credit ratings, a ratio between three percent (3%) and less than ten percent (10%) has a neutral effect on credit ratings and a ratio of ten percent (10%) or greater has a negative effect on credit ratings.

ANNUAL AUDITED FINANCIAL STATEMENTS

The annual Comprehensive Annual Financial Report (CAFR) of the County shall describe all funds and fund balances established as part of any direct debt financing of the County. The CAFR may also contain a report detailing covenants contained in any direct offering of the County and whether or not such covenants have been satisfied. The Auditor-Controller is responsible for the accuracy and completeness of the CAFR.

FINANCIAL DISCLOSURE, MONITORING, AND RECORDKEEPING

To assure clear, comprehensive, and accurate financial information, the County is committed to meeting secondary disclosure requirements on a timely and comprehensive basis, cooperating fully with rating agencies, institutional and individual investors, County departments and agencies, other levels of government, and the general public. Complete and accurate disclosure supports the taxable or tax exempt status of bonds issued by the County and provides transparency regarding County finances and operations.

The CAO, Treasurer, and Auditor-Controller, pursuant to their authority, shall be responsible for the following as they apply to County long-term and short-term debt issues:

1. Providing the trustees and/or dissemination agents ongoing disclosure information for filing with the Municipal Securities Rulemaking Board via the Electronic Municipal Markets Access (EMMA). The County may elect to utilize the services of a dissemination agent for continuing disclosure reporting; however, the responsibility for ensuring the reports are filed timely remains with the County.

2. Maintaining compliance with disclosure standards promulgated by State and Federal regulatory bodies, such as annual reporting to the California Debt and Investment Commission of the State Treasurer's Office in accordance with SB1029 for debt issued after January 1, 2017.

3. Ensuring the CAFR and continuing disclosure statements meet (at a minimum) the standards articulated by the Government Accounting Standards Board (GASB), the Securities and Exchange Commission (SEC), and Accounting Principles Generally Accepted in the United States (US GAAP).

4. Monitoring to ensure all covenants and annual continuing disclosure requirements are complied with, including requiring each County department, agency, district or authority to notify the CAO immediately upon the occurrence of any event, specified in Rule 15c2-12 under the Securities Exchange Act of 1934, which must be filed with

EMMA. Examples of such events are credit rating downgrades, major disasters, major litigation, default on existing debt, bankruptcy, etc. and for TRAN issuance, ensuring cash deficit requirements are met for each issuance, in order to meet arbitrage and rebate requirements and protect the tax exempt status of each issuance.

5. Providing an annual certification to the Board documenting the County's compliance or non-compliance with State and federal disclosure laws. This certification shall be tendered at the first meeting of the Board in April of each year.

6. Annually, applying the private business use, private payment or security, and the private loan financing tests to ensure the tax exempt bond issues are not issues of private activity bonds. Monitoring shall include:

(a) Reviewing the amount of existing private use of bond-financed facilities,

(b) Identifying any new sale, lease or license, management contract, or other arrangements involving the private use of a bond-financed facility, and

(c) Promptly consulting with bond counsel as to any possible private use of a bond-financed facility and any necessary remedial action. Generally, an issuer will not loan more than 5% of the proceeds of an issue to one or more nongovernmental persons. The issuer does not expect to allow and will not allow more than 10% of the sale proceeds and investment proceeds of the issue or of the bond-financed facility to be privately used directly or indirectly by any nongovernmental person in any trade or business, other than as a member of the general public. For purposes of the preceding sentence, "10%" is reduced to "5%" for nongovernmental use of any facility financed or refinanced from the proceeds of an issue which are disproportionate to or not related to the governmental purposes of the issue. Absent an opinion of counsel a nongovernmental person is treated as "privately using" proceeds of the issue to the extent the nongovernmental person:

(i) borrows proceeds of the issue,

(ii) uses the bond-financed facility (e.g., as owner, lessee, service provider, operator or manager), or

(iii) acquires the output (or throughput) of the bond-financed facility.

7. Establishing and maintaining a system of monitoring, reporting and recordkeeping to meet the arbitrage rebate compliance requirements of the federal tax code. Arbitrage in the municipal bond market is the difference in the interest paid on the tax-exempt bonds and the interest earned by investing the bond proceeds in taxable securities. If interest rates on investments are higher than the interest on the bonds, there is positive arbitrage. The tax code requires that, to the extent the investment yield exceeds the bond yield, such excess must be rebated to the federal government, subject to the exceptions discussed in paragraph (c), below. The system shall include annually:

(a) Ensuring investments of proceeds comply with yield restrictions throughout their investment life;

(b) Tracking the investment earnings on bond proceeds since issuance and calculating any rebatable earnings (rebatable earnings are amounts earned from the investment of the gross bond proceeds at a yield in excess of the yield on the issue);

(c) Applying exceptions to the application of rebatable earnings for certain investments of bond proceeds [e.g., if investments were (i) during a temporary period, (ii) part of a reasonably required reserve or replacement fund, or (iii) as part of a minor portion (an amount not exceeding the lesser of 5% of the sale proceeds of the issue or $100,000)];

(d) Remitting any rebatable earnings to the Federal government no later than sixty (60) days after the end of every fifth (5th) bond year throughout the term of a bond issue. The CAO has the authority to contract with parties specializing in arbitrage/rebate calculations, if deemed necessary; and

(e) Satisfying the Arbitrage Rebate/Yield Reduction Filing Requirements-Form 8038-T or Form 8038-R, if applicable.

8. Ensuring debt service for all existing and anticipated debt is properly budgeted and appropriated for each fiscal year and documenting any specific revenue sources for repayment.

9. Initiating scheduled debt service payments.

10. Reconciling bank statements for money managed by trustees.

11. Developing procedures to verify all payments for construction and other debt related expenditures (CAO, in cooperation with the Auditor-Controller). The most recently approved Construction and Debt Related Expenditure Verification Procedures ("Procedures") are attached hereto as Appendix B. The Committee shall have the sole authority to approve the Procedures, including the accompanying Internal Controls Checklist for Construction and Debt Related Expenditures, and all amendments thereto.

12. Retaining all material records related to bond financings, in a combination of paper and electronic forms, including, but not limited to:

(a) Records relating to the bond transaction, including documents prepared by bond counsel, audited financial statements, offering documents (including the official statements), minutes and resolutions authorizing the bond financings, appraisals, surveys, feasibility studies, documents related to government grants, publications/articles related to County bond financings, correspondence, any IRS correspondence or examinations, and arbitrage related documents and calculations;

(b) Documentation evidencing expenditure of bond proceeds;

(c) Documentation evidencing use of bond-financed property;

(d) Documentation of allocation of bond proceeds to issuance costs;

(e) Copies of construction and purchase contracts, requisitions, draw schedules, draw requests, invoices, bills, and cancelled checks related to bond proceeds spent for construction or purchase of bond financed facilities;

(f) Copies of all agreements, contracts, leases, subleases, ownership documentation, and entity formation documentation;

(g) Documentation evidencing all payments and security for the bonds;

(h) An asset list or schedule of all bond-financed facilities or equipment;

(i) Depreciation schedules for bond-financed depreciable property; and

(j) The tracking of purchases and sales of bond-financed assets.

13. Maintaining material records for as long as the bonds are outstanding plus three (3) years after the final redemption date of the bonds.

14. Ensuring all County staff involved with debt issuance will be provided pertinent educational resources, enrolled in training/educational seminars and classes, and trained by knowledgeable staff to ensure compliance with all applicable Federal and State laws and regulations.

ETHICS AND CONFLICT OF INTEREST

Officers and employees of the County involved in debt issuance and debt management will not engage in any personal business activities that might impair their ability to make impartial decisions, or that could conflict with proper and lawful execution of the County's debt issuance and post-issuance management of debt and these DMGP.

APPENDIX A

PROPOSED FINANCING

Project Title:_____

Date of Request:_____

County Administration Staff Contact:

Name:_____
Phone Number:_____
Email Address:_____

PROJECT DESCRIPTION

Estimated Project Cost: $_____

Proposed Financing Amount: $_____

Amount of Cash Injection: $_____

Estimated Financing Closing Date:_____

Narrative:_____
_____
_____
_____
_____
_____

RECOMMENDATION
(Comparison and discussion of the financing proposals received for the project and staff recommendation)

_____
_____
_____
_____
_____
_____

JUSTIFICATION FOR FINANCING
(Detailed cost analysis, use of proceeds, justification for borrowing versus "pay as you go", public benefit to be provided by the project, useful life of project)

_____
_____
_____
_____
_____
_____

ANALYSIS

Estimated Financing Costs:_____

All-In True Interest Cost (if applicable):_____

Estimated Credit Rating (if applicable):_____

Credit Enhancement Recommended? Yes___ No___
If yes, provide details: _____
_____

General Fund Debt: Yes___ No___

Tax Exempt or Taxable: Tax Exempt ___ Taxable___

Does Cash Flow Analysis Demonstrate Operational Costs of the Completed Project Can Be Supported? Yes___ No___

Type and Structure of the financing:_____
_____
_____
_____

Pledged Asset(s):_____
_____
_____

Payment Terms:

Loan Term:_____years

Interest Rate: _____% Fixed _____ Variable_____

Payment Frequency: Principal: _____ (Quarterly, Semiannually, Annually)
Interest: _____ (Quarterly, Semiannually, Annually)

Estimated Annual Debt Service: $_____

Narrative:_____
_____
_____
_____
_____
_____
_____

Funding Sources:

Cash Injection:_____

Debt Service:_____

Narrative:

_____

_____

_____

Prepayment Penalty: Yes___ No___
If yes, provide prepayment penalty terms:_____

_____

Affordability Guidelines:

When analyzing the appropriateness of a debt issuance, the County of Butte Debt Management Guidelines and Procedures (DMGP) requires the County to compare generally accepted measures of affordability to the ratios calculated for the County. Debt ratios are one of the key factors influencing a bond rating issued by a credit rating agency.

Ratios for Butte County after the closing of the proposed financing:

(a) Net Direct Debt/Property Valuations (2% or less recommended in DMGP)

_____

(b) Net Direct Debt/Operating Revenues (Less than 67% recommended in the DMGP)

_____

(c) Total Governmental Funds Debt Service/Total Governmental Expenditures (Less than 5% recommended in the DMGP)

_____

FOR CONDUIT FINANCINGS:

Ratio after the funds of the proposed conduit financing are fully issued:

Overall Debt/Property Valuations

[DMGP guidelines: Less than 3% has a favorable effect on credit ratings;
3% to less than 10% has a neutral effect on credit ratings; and
10% or greater has a negative effect on credit ratings]

PENDING FINANCINGS (5 YEAR HORIZON)

Year Needed	Amount of Financing	Repayment Source	Project Description

Total Governmental Funds Debt Service/Total Governmental Expenditures (Less than 5% recommended in the DMGP)

1 Year: _____ 5 Year Forward Average: _____

ADDITIONAL CONSIDERATIONS

(a) Are the affordability ratios within the ranges recommended in the DMGP and support the County's ability to afford the proposed debt? Yes___ No___
If no, provide an explanation:_____

(b) Does the average life of the project significantly exceed the five year minimum useful life and repayment period required under the DMGP? Yes___ No___
If no, provide an explanation:_____

(c) Are the long-term cash flows of the repayment sources forecasted to be sufficient to support the proposed debt service for the full term? Yes___ No___
If no, provide an explanation:_____

(d) Are the current market conditions favorable for financing debt? Yes___ No___
If no, provide an explanation:_____

(e) The long-term financing of the project versus the pay as you go method of funding allows this high priority project to be completed more quickly and reduces the burden on the funding sources so other essential capital projects may be pursued. Yes___ No___

Additional comments:
_____
_____
_____
_____

Debt Advisory Committee Recommendation:

Vote Count: APPROVE __ MODIFY __ DENY __ ABSTAIN __ ABSENT ___

_____
_____
_____
_____
_____

Dissenting Opinion(s), as applicable. Attach additional documentation, if needed.

_____
_____
_____
_____

Recommended Financing Team, if applicable

Bond Counsel: _____Financial Advisor: _____

Underwriter: _____Trustee: _____

APPENDIX B

CONSTRUCTION AND DEBT RELATED EXPENDITURE VERIFICATION PROCEDURES

Invoices for financed capital assets and/or capital improvements must be processed in accordance with the following procedures:

(a) Responsible Department

(i) Verifies the invoice complies with the contract terms,

(ii) Determines the work being invoiced has been satisfactorily completed and the charges are correct, and

(iii) Initials the invoice indicating approval to pay

(b) Responsible Department

(i) Verifies the invoice complies with the contract terms,

(ii) Verifies sufficient funds have been appropriated and are available to make the payment, and

(iii) Verifies the remaining encumbered funds are sufficient to cover the invoice

(c) Responsible Department

(i) Reviews and approves the payment of the invoice

(d) Responsible Department

(i) Verifies the invoice complies with the contract terms

(e) Responsible Department

(i) Provides copies of the approved invoice and supporting documentation to County Administration

(f) County Administration

(i) Submits a disbursement request to the lender. When approved, the lender will wire the funds to the County, or

(ii) In the case of use of dedicated bond proceeds, submits an itemization of the requested disbursement to the Treasurer-Tax Collector and the Auditor-Controller

(g) Responsible Department

(i) Prepares and submits the request for payment to the Auditor-Controller's office in accordance with the County's accounts payable procedures

(h) County Administration

(i) In the case of an incoming wire of financing proceeds, provides the Auditor-Controller and the Treasurer-Tax Collector the amount and date of the wire and the applicable coding on the prescribed ACH/Wire Transfer Form containing an authorizing signature. For recurring payments, establish a wire or ACH template with the Treasurer-Tax Collector at least one month prior to the first payment.

(i) Auditor-Controller

(i) Verifies the invoice has been approved for payment by the parties with legal authority,

(ii) Verifies there are available appropriations for the payment,

(iii) Verifies the invoice is from a legitimate company for which the County holds a current IRS Form W9, and

(iv) Pays the invoice from the financing proceeds or, in the case of a bond issue, from the Project Fund previously established with the bond proceeds.

The responsible staff position section of the Internal Controls Checklist for Construction and Debt Related Expenditures ("Checklist"), attached hereto, must be completed at the close of each new financing and submitted to County Administration and the Auditor-Controller. The completed Checklist will be maintained in the appropriate construction file.

INTERNAL CONTROLS CHECKLIST
FOR
CONSTRUCTION AND DEBT RELATED EXPENDITURES

Effective Date: October 24, 2017
Approved by Debt Advisory Committee

RESPONSIBILITIES DELEGATED PURSUANT TO THE CONSTRUCTION AND DEBT RELATED EXPENDITURE VERIFICATION PROCEDURES (Exhibit "B" to the County of Butte Debt Guidelines and Procedures)	RESPONSIBLE DEPARTMENT	RESPONSIBLE STAFF POSITION
(a)		
(i) Verify the invoice complies with the contract terms		
(ii) Determine the work being invoiced has been satisfactorily completed and the charges are correct		
(iii) Initial the invoice indicating approval to pay		
(b)		
(i) Verify the invoice complies with the contract terms		
(ii) Verify sufficient funds have been appropriated and are available to make the payment		
(iii) Verify the remaining encumbered funds are sufficient to cover the invoice		
(c)		
(i) Review and approve the payment of the invoice		
(d)		
(i) Verify the invoice complies with the contract terms		
(e)		
(i) Provide copies of the approved invoice and supporting documentation to County Administration		
(f)	County Administration	
(i) Submit a disbursement request to the lender or		
(ii) Submit an itemization of the requested disbursement to the Treasurer-Tax Collector and Auditor-Controller,		
if required		
(g)		
(i) Prepare and submit the request for payment to the Auditor-Controller in accordance with the		
County's accounts payable procedures		
(h)	County Administration	
(i) In the case of an incoming wire of financing proceeds, provides the Auditor-Controller and the Treasure-		
Tax Collector the amount and date of the wire and the applicable coding on the prescribed ACH/Wire Transfer		
Form containing an authorizing signature		
(i)	Auditor-Controller	
(i) Verify the invoice has been approved for payment by the parties with legal authority		
(ii) Verify there are available appropriations for the payment		
(iii) Verify the invoice is from a legitimate company for which the County holds a current IRS Form W9		
(iv) Pay the invoice from the financing proceeds or from the Project Fund established with the bond proceeds, as		
applicable		

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