City of Wauwatosa
Debt Management Policy

Revised 10/1/2020

I. Overview

Debt issuance is a useful tool for financing capital assets and other long term projects as well as providing a cost-effective source of funding for other purposes including economic development. It allows the City to continually invest in its infrastructure and accomplish other public purposes while more equitably spreading the tax burden over time. However, debt must be cautiously managed to ensure affordability, compliance and fiscal health.

II. Policy Goal

To establish parameters and provide guidance governing the issuance and management of debt obligations so that the City of Wauwatosa:

A. Maintains a high investment grade rating to minimize borrowing costs and to preserve ready access to capital;
B. Minimizes financial risk;
C. Achieves a balance between affordable debt levels and an appropriate amount of infrastructure and other investments;
D. Organizes the City's debt mix (i.e., short term and long term; general obligation, revenue obligation and RDA) to maximize fiscal strength and flexibility.

III. Policy Guidelines

A. Purposes of Debt Issuance
  1. Debt proceeds should be limited to financing capital assets or long-term projects with a useful life of at least the term of the debt.
  2. Debt financing should not be used for any recurring purpose such as current operating expenditures.
  3. Priority should be given to using debt proceeds for maintaining existing infrastructure followed by investments that would provide for tax base expansion and economic development.
  4. Debt proceeds should only be used for projects approved by the Common Council as part of the 5-year Capital Improvement Plan unless there is an

emergency, extenuating circumstance or a compelling public purpose opportunity.

B. Allowable Types of Debt

1. Debt financing will include general obligation bonds and notes, revenue bonds, State Trust Fund loans and special assessment bonds. Other types of debt instruments can be used as appropriate if their use is necessary or advantageous to the City. All bond and note issues must be authorized under Wisconsin Statutes, Chapter 66 or 67. State Trust Fund Loans are authorized under Wisconsin Statutes Chapter 24.66.

2. Refunding debt issues are permitted provided that they either produce a positive present value savings or restructure debt service payments in a manner that would be advantageous to the City. In general, advance refundings for economic savings will be undertaken when the net present value savings of at least 3.0% of the refunded debt can be achieved. Current refundings that produce net present value savings of less than 3.0% may be considered when there is a compelling public policy objective.

C. Debt Limitations

1. Property-tax backed General Obligation Debt

   a) The State of Wisconsin limits total general-obligation debt to be no greater than five percent of equalized valuation of taxable property within the City. However, recognizing the important role of debt capacity in financial sustainability, the City will follow a stricter standard of no greater than 4.0%

   b) To further ensure that annual debt service payments do not put unsustainable strain on the operating budget, total annual debt service for property-tax paid general obligation debt shall not exceed 15% of total general fund expenditure (including transfers) absent an emergency, extenuating circumstance or compelling public policy opportunity.

   c) Staff will monitor Direct Net Debt as a percentage of equalized value as compared to the national median of Aaa communities. Direct net debt represents general obligation debt, including State Trust Fund loans, net of debt supported by non-property tax revenues. This does not include debt incurred by the Redevelopment Authority and the Water, Sanitary and Storm sewer systems.

2. Rate revenue supported General Obligation Debt

   a) *The City currently issues general obligation debt to finance storm and sewer utility projects. The debt service is funded through the sewer rates. Prior to issuing any general obligation debt to-be-paid for through utility rates, an analysis must be completed demonstrating the impact of the debt service on the fund balance. Should operating funds and the fund balance be insufficient to support the term of the debt, the likely impact on rates must be included in that analysis and communicated to policy makers.*

3. *Revenue Bonds*

   a) *The City currently issues bonds backed by revenue for the Water Utility. In order to ensure adequate revenues, a coverage ratio of debt to equity of 1.25 will be maintained as a minimum level with a goal of maintaining a ratio of 1.50.*

4. *Cash Financing*

   a) Recognizing the important role of cash financing in maintaining an appropriate balance between debt and capital infrastructure renewal, 40% of the capital budget, not including tax increment financing, will be cash financed (i.e. use funds on-hand instead of borrowing) by 2030.

D. Structure of Debt

1. Debt schedules should be structured to minimize fluctuations in total debt service payments while achieving 75% of principal retirement of all general obligation debt within 10 years.
2. In order to limit the amount of debt issued by the City, any cash balances in excess of the City's stated general fund balance target should be used for capital projects. One-time revenues should be used for capital projects to reduce borrowing or for debt elimination.

E. Debt Issuance and Management Practices

1. The City may issue debt on either a negotiated or public sale basis at its sole discretion. If the issue is negotiated, a compelling business case must be documented as to the unique circumstances that make a negotiated sale preferable and a minimum of three similar issuances in size, ratings, and purpose on or near the sale date should be presented in order to evaluate the negotiated price.

2. The City may employ outside financial specialists to assist in developing a financing strategy, preparing bond documents and marketing the issue to investors. Independent bond counsel shall also be retained in order to ensure the bond sale complies with all state law and federal regulations and to assist in preparing legal documents.

3. Interfund borrowing will be considered to finance high priority needs on a case-by-case basis, only when planned expenditures in the fund making the loan would not be affected. Interfund borrowing may be used when it would reduce costs of interest, debt issuance, and/or administration. An interest rate based on that fund's expected investment earnings shall be charged.

F. Compliance

1. The City will seek to maintain its current bond rating and will ordinarily not consider long-term debt that, through its issuance, would likely cause the City's bond rating to be lowered.

2. The City will strive to maintain good relations with the rating agency and keep them informed of significant developments that could affect the City's credit rating.

3. The City will monitor compliance with bond covenants and adhere to state and federal law including IRS arbitrage regulations. The City has in place a compliance procedure and checklist to ensure adherence to IRS arbitrage regulations for each issuance of debt. To this end, bond proceeds will be kept in a segregated account at the State of Wisconsin Local Government Investment Pool. Interest earnings will be tracked quarterly and allocated to the capital project fund. The spending of proceeds will be tracked by issuance. Any instances of non-compliance will be reported to the Common Council.

4. All factual information submitted for official statements and other relevant disclosures shall be submitted to and reviewed by a Disclosure Group, which shall consist of representatives of the Finance Department, City Attorney, Human Resources, Economic Development and each department which will be utilizing the proceeds of that particular borrowing. The Disclosure Group shall determine and utilize best practices in order to ascertain and assure full compliance with all relevant disclosure requirements at the time of each borrowing.

5. The City is committed to full and complete financial disclosure, and to cooperating fully with rating agencies, institutional investors, other units of governments, and the general public to share clear comprehensible and accurate financial information. The Finance Department will provide continuing

disclosure in compliance with continuing certifications made at the time of each debt issue.

Definitions

Arbitrage is the ability to obtain low-yielding tax-exempt bond proceeds and invest the funds in higher yielding taxable securities, resulting in a profit. In order to maintain tax-exempt bond status the IRS requires yield restrictions and that the bond proceeds be utilized in a specific duration of time.

A **bond** is a debt security issued by certain institutions such as companies and governments. A bond entitles the holder to repayment of the principal sum, plus interest. Bonds are issued to investors in a marketplace when an institution wishes to borrow money. Bonds have a fixed lifetime, usually a number of years; with long-term bonds, lasting over 30 years, being less common. At the end of the bond's life the money should be repaid in full. Interest may be added to the end payment, or can be paid in regular installments (known as coupons) during the life of the bond. Bonds may be traded in the bond markets, and are widely used as relatively safe investments in comparison to equity.

Capital Assets are any asset used in operations with an initial useful life extending beyond one reporting period. Typically capital assets are physical structures, larger pieces of equipment or land.

Debt is simply funds that have been borrowed and must be repaid with interest. In terms of municipal finance, debt typically refers to outstanding bonds which have been used to finance capital projects, typically infrastructure investments. Debt financing allows governments to spread the cost of a capital project over a period of time (typically 10-20 years). This has the advantage of allowing for the construction of public infrastructure such as roads, bridges and sewers on a more regular basis as opposed to waiting for sufficient funds to be set-aside. It also allows for the cost of projects to be paid for by a greater number of tax-payers who enjoy the project's benefit. This is often referred to as inter-generational equity.

Debt Service refers to annual principal and interest payments on outstanding debt.

General Obligation Debt represents debt that is backed by the full faith and credit of a governmental entity and its property tax base.

Operating Expenditures refers to the annual recurring costs associated with operating a government.

Refunding Debt is a type of debt used to refinance existing debt, typically to take advantage of lower interest rates.

Revenue Obligation Debt is debt which will be repaid using a non-property tax revenue such as water utility payments.