

**STAFF REPORT FOR CALENDAR ITEM NO.: 10  
FOR THE MEETING OF: May 8, 2014**

**TRANSBAY JOINT POWERS AUTHORITY**

**BRIEF DESCRIPTION:**

Presentation of a Debt Management Policy for adoption by the Board of Directors.

**SUMMARY:**

Staff proposes that the Board of Directors adopt a Debt Management Policy that will provide guidelines for the borrowing of money and the issuance of debt by the TJPA.

**EXPLANATION:**

A debt management policy is a recommended financial best practice, as it proactively safeguards public agencies from making unsuitable debt-related decisions, and establishes an effective management mechanism for post-issuance disclosure and tax compliance.

The proposed TJPA Debt Management Policy is intended to provide general guidance on debt issuance. To the extent a specific issuance presents unique issues not covered by this policy, those issues will be addressed at the time of the issuance. At this time, TJPA does not anticipate issuing bonds or notes, and thus the policy does not contain specifics on this type of debt issuance. If TJPA plans to sell bonds or notes in the future, the policy will be amended at the appropriate time.

TJPA currently has a TIFIA loan, which has not yet been drawn upon. TJPA recently conducted a request for proposals process to explore the possibility of issuing interim debt to be repaid in whole or in part by the future receipt of TIFIA proceeds and/or secured by the net tax increment revenues securing the TIFIA loan. In the responses to that request for proposals, several banks and investment banks proposed the use of variable rate financing and the possibility of hedging the variable rate risk through the negotiation of an interest rate swap contract. After the passage of the Dodd-Frank Act, Commodities Future Trading Commission (CFTC) rules and regulations prohibit financial institutions from discussing interest rate swaps with municipalities such as TJPA unless the municipalities have adopted policies and procedures that address these CFTC rules and regulations. The attached policy includes the necessary procedures.

Adoption of this policy demonstrates TJPA's commitment to long-term capital and financial planning, and adherence to the policy will signal rating agencies and the capital markets that the agency is well managed and therefore likely to meet its debt obligations in a timely manner. The policy includes the following objectives:

- publicly announce the minimum criteria necessary when banks and investment banks propose financing transactions to TJPA, including compliance with rules and regulations relating to derivatives.
- maintain cost effective access to capital markets through prudent debt management policies and practices.
- maintain moderate debt and debt service levels with effective long-term planning.
- meet capital needs through debt financing as needed.

- structure long term financings to minimize transaction specific risk and total debt portfolio risk.
- maintain the highest practical credit ratings to ensure efficient access to capital markets.
- maintain good investor relations through the timely dissemination of material financial information.

The policy includes three key sections: Debt Limits & Structure, Debt Issuance, and Debt Management. The Debt Limits & Structure section governs the use of long-term or short-term debt and fixed rate or variable rate debt, the use of derivative contracts consistent with CFTC rules and regulations, and the use of the security for repayment of the debt. The Debt Issuance section governs the method of sale, use of consultants, and ethics and conflicts of interest. The Debt Management section governs internal controls, investment of debt proceeds, and recordkeeping.

There is no legal requirement for regular or periodic review of a debt policy by a local agency board; however, the TJPA's Debt Management Policy shall be reviewed by the Board no less frequently than annually.

**RECOMMENDATION:**

Staff recommends that the TJPA Board of Directors approve the proposed Debt Management Policy.

**ENCLOSURE:**

1. Resolution
2. Proposed Debt Management Policy

**TRANSBAY JOINT POWERS AUTHORITY  
BOARD OF DIRECTORS**

**Resolution No. \_\_\_\_\_**

WHEREAS, Due to the timing of availability of long-term revenue streams for the Transbay Transit Center Program, the Transbay Joint Powers Authority (“TJPA”) will require a significant amount of financing to be issued to support the cost-effective and timely delivery of the Program; and

WHEREAS, TJPA has an outstanding TIFIA Loan and is negotiating an additional private placement direct loan; and

WHEREAS, Prudent financial management principles require a debt management policy to organize and formalize debt issuance-related policies and procedures; and

WHEREAS, TJPA staff, financial advisors, and bond counsel have prepared the attached Board Policy No. 017, Debt Management Policy, which complies with applicable regulations; now, therefore, be it

RESOLVED, That the TJPA Board of Directors adopts the attached Debt Management Policy identified as Board Policy No. 017, Category: Financial Matters.

I hereby certify that the foregoing resolution was adopted by the Transbay Joint Powers Authority Board at its meeting of May 8, 2014.

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Secretary, Transbay Joint Powers Authority

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# TRANSBAY JOINT POWERS AUTHORITY

Board Policy No. 017                      Category: Financial Matters

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## DEBT MANAGEMENT POLICY

### I. Introduction & Objectives

The purpose of this policy is to set forth debt issuance-related policies and procedures for the Transbay Joint Powers Authority to govern issuance and management of all debt, including the selection and management of related financial and advisory services and products. The primary objectives are to:

- maintain cost effective access to capital markets through prudent debt management policies and practices.
- maintain moderate and sustainable debt and debt service levels with effective long-term planning.
- meet capital needs through debt financing as needed.
- structure long term financings to minimize transaction specific risk and total debt portfolio risk.
- maintain the highest practical credit ratings to ensure efficient access to capital markets.
- maintain good investor relations through the timely dissemination of material financial information.

### II. Governing Authority

This policy is subject to and limited by applicable provisions of federal and state law and prudent debt management principles.

### III. Delegation of Authority

This policy requires that the Board authorize each debt financing. Responsibility for implementation of this policy, and day-to-day responsibility and authority for structuring and managing the TJPA's debt, is hereby delegated to the TJPA Chief Financial Officer or his or her designee.

While adherence to this policy is required in applicable circumstances, the TJPA recognizes that changes in the public and private debt markets, the Transbay Program, or other unforeseen circumstances may from time to time produce situations that are not covered by the policy and require modifications or exceptions to achieve policy goals. In such cases, management flexibility is appropriate.

## DEBT LIMITS & STRUCTURE

### IV. Types of Debt

#### Term and Use

TJPA may issue debt when there is a defined repayment source. TJPA may incur short-term or

long-term debt. Short-term debt is debt with a term to maturity of less than five years. Long-term debt has a term to maturity of five years or more. TJPA's long-term debt will be structured such that obligations do not exceed the maturity permitted by law or the average useful life of the capital asset as determined by the Internal Revenue Code, if applicable. Long-term debt shall not be used to fund operating costs or operating deficits of the TJPA. Short-term debt may be used to either, 1) provide funds to finance cash flow deficits, or 2) provide capital financing.

### **Rate**

To maintain a predictable debt service burden, TJPA may give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is floating or variable rate debt. It may be appropriate to issue variable rate debt to reduce forecast interest costs, provide interim financing, and/or improve the match of assets to liabilities. Under no circumstances will TJPA issue variable rate debt solely for the purpose of earning arbitrage. In connection with each issuance of variable rate debt, TJPA should make a determination that the use of unhedged variable rate debt is not imprudent, taking into consideration the security source for repayment of the variable rate debt and the projected coverage if variable rate debt was to equal the maximum rate permitted under the applicable debt.

Adequate safeguards against the risk of adverse impacts from interest rate shifts in variable debt may include, but are not limited to, interest rate swaps, interest rate caps, and the matching of assets and liabilities. Financial strategies may result in a synthetic fixed rate debt, subject to the provisions of this policy regarding derivative products.

## **V. Financial Derivative Products**

Financial derivative products such as interest rate swaps will be considered appropriate in the issuance or management of debt only in instances where it has been demonstrated that the derivative product will either provide a hedge that reduces the risk of fluctuations in expense or revenue, or alternatively where the derivative product will significantly reduce the project cost. Financial derivative products will only be considered, 1) after a thorough evaluation of risks associated therewith, including counterparty credit risk, basis risk, tax risk, termination risk, and liquidity risk; 2) after consideration of the potential impact on the TJPA's ability to refinance debt at a future date; and 3) in compliance with the requirements below.

### **A. Qualified Independent Representative**

1. TJPA will enter into a contract with a firm or firms that will have the qualifications to act as a qualified independent representative ("QIR") to TJPA in accordance with the requirements of Commodity Futures Trading Commission ("CFTC") Regulation §23.450, "Requirements for swap dealers and major swap participants acting as counterparties to Special Entities", and its related safe harbor provisions and in such contract such firm or firms will make representations and provide agreements to satisfy the requirements and safe harbors of CFTC Regulation §23.450 in a manner satisfactory to TJPA.
2. TJPA shall utilize the services of such QIR when (i) entering into a new swap transaction, (ii) modifying, terminating (in whole or in part), transferring or novating an existing swap transaction, or (iii) discussing the possibility of the transactions in (i) and/or (ii) with a swap counterparty.

3. TJPA shall monitor the continued performance of each QIR by requesting certifications at least annually from each QIR restating that the representations and agreements in the contract described in (1) above are true and correct and by requiring in the contract described in (1) above prompt notice by the QIR of any failure of a representation or agreement to be true and correct.

#### **B. Recordkeeping and Retention**

TJPA will maintain full records (in the manner specified in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”)) related to interest rate swap agreements, interest rate swap transactions, and similar agreements for at least five years following the final termination of each transaction. Such records must be retrievable within five business days.

#### **C. Consent to Recording**

Each employee or representative of TJPA that enters into discussions with a swap counterparty regarding a swap transaction or the International Swaps and Derivatives Association (“ISDA”) master agreement (including the related schedule and credit support annex, if applicable) that governs such swap transaction acknowledges and agrees that the discussions will be recorded by the swap counterparty and consents to the recording and agrees to sign an annual acknowledgement form stating that they have notice of and consent to the recording of discussions of swap documentation and transactions.

#### **D. Amendment of documentation for interest rate swap agreements, interest rate swap transactions, or similar agreements.**

TJPA will work with legal counsel and a QIR to amend ISDA master agreements entered into with swap counterparties to comply with requirements of the Act and regulations thereunder and any additional legal and/or regulatory requirements relating to swap transactions and ISDA master agreements. TJPA will amend documentation through completion and distribution of applicable ISDA Protocol documentation and/or through direct negotiation of amendments with individual swap counterparties.

#### **E. Counterparty and contract guidelines.**

TJPA will not use derivative contracts that are purely speculative in nature or create extraordinary leverage or risk, or lack sufficient price transparency to allow reasonably transparent valuation.

TJPA will only work with counterparties (or their guarantors) with a long-term senior, unsecured debt credit rating of at least “A3” or “A-” from two of the nationally recognized rating agencies.

No derivative contract will be entered into with a structured terminating counterparty or be subject to automatic termination in any circumstance without the explicit approval of the Board.

All termination payments under any contract shall be expressly subordinate to the payment of debt service payments on the debt being hedged, unless the Board explicitly approves otherwise.

Each counterparty with TJPA must provide collateralization to secure any or all of its payment obligations under the derivative contract under terms and provisions acceptable to TJPA and the QIR, provided that, if any of the counterparty's (or guarantor's) ratings fall below investment grade, the credit support agreement must provide for a zero threshold limit for the initial deposit and for increments or decrements of collateral thereafter.

TJPA will consider diversifying its counterparties so that an excessive amount of exposure is limited to one or a small number of institutions.

The TJPA Chief Financial Officer is required to prepare a report summarizing derivative exposure at least annually.

## **VI. Structuring**

Debt issuance shall be planned to achieve relatively rapid repayment of debt while recognizing the useful life of the facilities.

Certain types of financings may require the use of capitalized interest from the issuance date until the TJPA has constructive use of the financed project. Capitalized interest is the interest added to the cost of a debt-financed long-term asset. Capitalized interest may be funded from the proceeds of TJPA debt.

Reserve accounts shall be maintained per debt requirements and where deemed advisable by the TJPA Board. Debt service reserves shall be structured so that they do not violate Internal Revenue Service arbitrage regulations.

## **DEBT ISSUANCE**

### **VII. Method of Sale**

TJPA will determine, on a case-by-case basis, whether to issue its debt competitively or through negotiation.

In a competitive sale, the transaction shall be awarded to the bidder providing the lowest true interest rate cost as long as the bid adheres to the requirements set forth in the procurement documents. A competitive sale may be the most appropriate when the debt type and structure are conventional and the issuer has a strong credit rating and is well known to investors.

TJPA recognizes that some transactions are best handled through negotiation, including situations when sale of the debt will require complex explanations about TJPA's projects, political structure and support, funding, or credit quality.

From time to time, TJPA may elect to privately place its debt with institutional investors. Such placement shall be considered if this method is likely to result in a cost savings or additional benefit to the TJPA relative to other methods of debt issuance, whether due to interest rate savings or costs of issuance.

## **VIII. Consultants**

All professional service providers (underwriters, financial advisors, QIRs, bond counsel, etc.) shall be selected in accordance with Board Policy No. 001: Procurement Policy.

## **IX. Ethics and Conflict of Interest**

Officers and employees involved in the debt management process will not engage in personal business activities or investments that could conflict with the proper and lawful execution and management of the debt management program, or that could impair their ability to make impartial decisions. Pursuant to the TJPA's Conflict of Interest code, employees shall disclose any material interests in financial institutions with which they conduct business. They shall further disclose any personal financial/investment positions that could be related to TJPA's debt.

## **DEBT MANAGEMENT**

### **X. Internal Controls**

TJPA shall maintain a system of internal controls, which shall be documented in writing. The internal controls shall be provided to and reviewed by the independent auditor. The controls shall be designed to ensure compliance with this policy, all debt covenants, and any applicable legal requirements.

### **XI. Investment of Debt Proceeds**

TJPA shall accurately account for all interest earnings in debt-related funds. TJPA will maximize the interest earnings on all funds within the investment parameters set forth in the respective indenture documents or as otherwise permitted by the TJPA Investment Policy. TJPA will implement a system of reporting interest earnings that relates to and complies with any tax certificates relating to its outstanding debt and Internal Revenue Code requirements, and make any required filings with federal and state agencies.

### **XII. Post-Issuance Compliance Procedures**

TJPA will establish and document procedures to ensure compliance with all Internal Revenue Code requirements with respect to tax-exempt bonds and obligations so that the interest on the bonds and obligations is and will remain tax-exempt.

### **XIII. Recordkeeping**

TJPA shall maintain all debt-related records for a period no less than six years after the final maturity of the debt. At a minimum, these records shall include all official statements, term sheets, bid documents, resolutions, disclosure reports, and consultant agreements.

### **XIV. Debt Management Policy Review**

TJPA's debt management policy shall be adopted by resolution of the TJPA Board of Directors. This policy shall be reviewed annually at a regular meeting of the TJPA Board, or more frequently as required. Any modifications to this policy must be approved by resolution of the TJPA Board.

## Glossary of Terms

**Arbitrage:** The difference between the interest paid on tax-exempt securities and the interest earned by investing the security proceeds in higher-yielding taxable securities. IRS regulations govern arbitrage on the proceeds from issuance of tax-exempt municipal securities.

**Capitalized Interest:** A portion of the proceeds of an issue that is set aside to pay interest on the securities for a specific period of time. Interest is commonly capitalized for the construction period of a project.

**Competitive Sale:** A sale of securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities.

**Debt Service Reserve Fund:** The fund in which moneys are placed which may be used to pay debt service if pledged revenues are insufficient to satisfy the debt service requirements.

**Derivatives:** 1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying indices or securities, and may include a leveraging factor, or 2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (e.g., interest rates).

**Indenture:** A legal and binding contract between a debt issuer and the debt holders. The indenture specifies all the important features of the debt, such as its maturity date, timing of interest payments, method of interest calculation, call features, investment requirements, etc.

**Negotiated Sale:** A method of sale in which the issuer chooses one underwriter to negotiate terms pursuant to which an underwriter will purchase and market the debt.

**Private Placement:** The original placement of an issue with one or a limited number of investors as opposed to being publicly offered or sold.

**Underwriter:** A dealer that purchases new issues of municipal securities from the issuer and resells them to investors.

**Variable Rate:** An interest rate on a security which changes at intervals according to an index or formula or other standard of measurement as stated in a debt contract.