CITY OF POUGHKEEPSIE, NEW YORK
Debt Management Policy Statement
Adopted October 16, 2017

"Debt management, like the budget itself, is an area vital to our hopeful future"

Mayor Rob Rolison, Budget Message to the Common Council, October 14, 2016

Robert G. Rolison
Mayor

Marc S. Nelson
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Preamble

The City of Poughkeepsie's ("The City") financial position weakened during the years between 2008 and 2015. The General Fund had a surplus fund balance of $5 million on December 31, 2007, which was reduced to an accumulated deficit of $13.1 Million by the end of 2015. In 2015 alone, the City experienced a $1.9 Million deficit. A number of factors contributed to these annual operating deficits including significant unfavorable variances on the revenue side, and a number of expenses running higher-than-projected. The financial crisis of 2008, which led to a precipitous decline in local property values of approximately 20% and the extended period of slow recovery, were also contributing factors.

There is no record of the City previously adopting a formal debt management policy. The following policy is adopted by the Common Council upon the recommendation of the Commissioner of Finance ("COF") and the City's Municipal Advisor. It seeks to position the City's debt plan amongst the best practices in municipal finance, as well as to underscore the City's commitment to curtail borrowing in the near term, in order to push forward with an aggressive plan to reduce the accumulated fund balance deficit.

Policy Objectives

The City recognizes that effective debt management practices require a comprehensive debt policy that details the use of capital and capital debt to support the services provided to its residents. Debt policies are financial management tools and a critical component of the City's internal controls. As such, these policies provide the guidelines for management's decisions concerning the appropriate debt levels relative to the City's available resources. The City's debt policy includes flexible goals, which are measured by applicable financial ratios. These goals may be achieved over time, as the City continues to improve its overall financial condition, and they may be modified to respond to new or changing circumstances.

Debt issued by municipalities in New York State is governed by provisions of the State Constitution and the Local Finance Law ("LFL"). In addition, Federal tax laws impose additional requirements in order for the debt-issuance to qualify for tax-exempt status. All debt issued by the City must be approved by Resolution of the City's Common Council ("Council"). The issuance of bonds and capital notes require a two-thirds vote of the Council, while Tax Anticipation Notes and Revenue Anticipation Notes require a simple majority vote and certain specific types of capital notes need only a simple majority.

This debt policy memorializes the City's obligation to fully comply with the provisions of State and Federal laws governing its debt. The City's goal is to improve its bond rating, which fell to below investment grade, and to preserve the highest credit rating possible with the allocation of resources to the programs and services provided by the City. This debt policy provides benchmarks and other background which will help City officials monitor the progress made towards meeting its credit goals.

This policy has been approved by resolution of the Common Council, dated October 16, 2017. The COF, as the Chief Financial Officer of the City, will administer this policy. The City's debt policy is intended to provide sufficient flexibility to allow for the issuance of debt to address unforeseeable events as of the date of this policy and to undertake future opportunities (such as refundings, for example, which may arise from time to time). A complete review of the City's debt policy shall be conducted by the COF every four years.

All changes to this policy shall be approved by Resolution of the Common Council.

In connection with City's annual audit, the independent auditors may examine the City's compliance with the various provisions of the debt policy in conjunction with their review of internal controls.

Nothing in this policy shall be deemed to affect or impair any outstanding obligations or any obligations issued to renew such outstanding obligations. Failure to comply with any goal or limit established by this policy shall not of itself be deemed to invalidate any obligations.

Capital Improvement Plan and the Capital Budget

The City's administration annually prepares and submits a five-year capital improvement plan ("CIP") to the Council for its consideration and approval. As a mid-range fiscal management tool, the CIP functions as a tentative forecast of infrastructure improvements and capital equipment procurements over a five-year period. Estimated costs and funding sources are listed for each asset. Subsequent to the Council's adoption of the CIP, the first year of the plan constitutes the City's capital budget for the ensuing fiscal year. The assets listed for the later four years of the CIP will be considered during the preparation of subsequent capital plans.

The City considers its debt policy to be an integral part of the CIP. Therefore, the CIP submitted to Council should include a prospective impact statement and analysis with respect to proposed capital budget improvements financed with debt obligations. The impact analysis should include an annual overlay of proposed and existing debt obligations and an evaluation of applicable debt ratios (see: Debt Limit and Ratio Analysis, herein). To assist with debt service assumptions, the COF may enlist the support of the City's Municipal Advisor and/or Bond Counsel.

Funding the Capital Program

The CIP shall be financed according to forecasted costs associated with each project and the overall efficiency of available funding sources. <u>Whenever possible, the City shall seek to procure grant opportunities to fund capital projects</u>. A City employee shall be designated to prepare grant applications with respect to capital and operational programs. In addition, the COF may contract with a firm or consultant specializing in grant services. Low cost loans administered through various State and Federal Agencies, subject to funding availability, shall also be reviewed for appropriateness and may take priority, particularly with respect to water and sewer projects.

At the discretion of the COF, the City will use a pay as you go financing program ("PAYGO") for certain low cost assets, such as police vehicles and other types of capital equipment. Accordingly, appropriations for PAYGO are included in the general operating budget. Depending on the availability of funding, the City may establish capital reserves pursuant to the General Municipal Law to augment the PAYGO program. <u>The City recognizes the importance of expanding the PAYGO program to reduce reliance on debt obligations, which includes interest and issuance costs.</u>

If deemed appropriate by the COF, certain low-cost assets with short useful lives may be financed through lease obligations. The COF shall analyze the cost effectiveness of any proposed lease transaction by comparing the cost/benefit of the proposed lease to alternatives such as PAYGO or general obligation debt instruments. The LFL limits the amount of lease financing the City may issue, which must be considered in the analysis for lease financing

Tax Anticipation and Revenue Anticipation Notes.

The City is authorized under the LFL to borrow in anticipation of the receipt of taxes or other forms of revenue (primarily in the form of State or Federal aid). Such borrowings take the form of short-term notes and provide working capital to balance timing differences between revenue and expenditures. The LFL and the U.S Internal Revenue Code (the "Code") limits the amount the City may borrow for working capital purposes. Detailed cash flow statements and other accounting records are essential to support legal compliance as well as structuring temporary investments for borrowed moneys. In addition to such notes, the LFL provides for budget notes in the event there is a deficiency in the operating budget. The amount of these notes is limited to a percentage of the adopted budget expenditures. As a matter of policy, the City should avoid budget notes unless the COF determines they are absolutely necessary due to potential negative credit implications or service disruptions.

Under normal circumstances, tax anticipation notes shall be fully paid on or before December 31 of each year. Revenue anticipation notes shall be paid in accordance to limitations of the LFL.

Sales Methods

Pursuant to the LFL, the City generally is required to sell its bonds by competitive bid. However, subject to the approval of the Office of the State Comptroller ("OSC"), under certain circumstances bonds may also be sold through a negotiated process. Negotiated sales may be appropriate if investor participation is limited by credit concerns or volatile market conditions. Many potential investors, including institutional investors, are prohibited from purchasing securities with a non-investment grade rating (Moody's ratings of Ba1 and below are considered non-investment grade). The ability to negotiate is vital under the aforementioned conditions because underwriters can conduct presale activities prior to finalizing their bid. The COF shall confer with the City's Municipal Advisor to determine the most appropriate method of sale based upon various issuance specific factors.

If a negotiated sale process is deemed appropriate, the Underwriter(s) shall be selected through a competitive process. The COF may request the City's Municipal Advisor to assist in this process, analyze proposals and provide recommendations with respect to the selection(s).

The City is permitted to sell short-term obligations such as bond anticipation or tax anticipation notes by either competitive or negotiated sale. The COF, in consultation with the City's Municipal Advisor, shall select the most appropriate method of sale so as to yield the lowest net interest cost possible.

Investment of Debt Proceeds

The COF is required to invest proceeds of obligations in accordance with the City's then current Investment Policy adopted in accordance with Section 39 of the General Municipal Law, Section 11 of the General Municipal Law, and in accordance with applicable federal tax requirements. New York State law permits the City to co-mingle debt proceeds with operating moneys under a pooled investment program. However, for disbursement purposes debt proceeds are required to be deposited in one or more demand accounts separate from other funds of the City. Accounting records shall be maintained to ensure that debt proceeds are spent for the purpose(s) for which they are authorized and in accordance with the City's Post Issuance Compliance Procedure and Policy.

Operational Cash Flow

The City must be certain that debt payments are timely and complete, without impairing its cash flow and subsequently its ability to provide essential governmental service. Accordingly, sufficient flexibility must be maintained so that fluctuations in revenue or unanticipated expenditures do not create financial instability. Debt payments, if not properly analyzed and monitored, can place an undue burden on the City's taxpayers. A comprehensive analysis of the City's debt capacity and ability to service such debts helps to ensure that debt remains affordable. As discussed above, an analysis of any proposed debt should be prepared and included with the CIP submitted to the Council (see "Capital Improvement Plan and the Capital Budget," herein). The COF shall confer with the City's Municipal Advisor to determining the most advantageous timing of payments. For cash flow management purposes, the selection of maturity date(s) for new issue debt obligations shall consider any liquidity concerns and may be scheduled to coincide with higher cash-flow periods surrounding such dates.

Constitutional and Statutory Limits on Debt

Pursuant to the State Constitution, the total amount of the City's outstanding debt may not exceed seven per centum (7%) of the five-year average taxable full valuation of property assessments. This is the Constitutional Debt Limit ("CDL"). The City's water debt, budgetary appropriations, and operational financings are excluded from the calculation of the CDL. Self-supporting debt, including sewer debt, paid from non-real property tax revenue may also be excluded in full or part if authorized by the OSC. If applicable, the COF should apply for all self-supporting debt exclusions in order to maintain sufficient debt capacity.

Internal Controls – Debt Limit

The City will generally issue debt to finance high cost capital assets which have significant useful lives. The LFL assigns periods of probable usefulness ("PPU") which determine the maximum period of time over which assets may be financed. If the COF determines the economic life of a tangible asset is less than the statutory PPU, the asset shall be financed over the lesser term. Short-term debt, primarily in the form of bond anticipation notes, may be utilized prior to the issuance of long-term serial bonds. With the assistance of the City's Municipal Advisor, the COF shall analyze such projects to determine the most appropriate financing structure

The City's constitutional debt limit exceeds its anticipated borrowing requirements. As such, more stringent internal controls to complement those specifically required under State Law shall assist the COF in effectively managing the City's indebtedness. The City has, therefore, elected to impose the following internal controls with respect to the debt limit:

Net Indebtedness. The City will seek to limit its net indebtedness to 60% of the CDL, excluding budgetary appropriations and debt obligations issued for water, sewer and operational purposes. If the full valuation of real property is negatively impacted for a reason outside of the City's direct control, such limitation will be subject to evaluation by the COF for appropriateness.

Internal Controls – Target Financial Ratios

The City's internal controls relating to debt will include various financial ratios, as detailed below. Such ratios have historically been utilized to evaluate municipal jurisdictions.

Long-Term Principal Repayment. The City shall review the payment structure of outstanding long-term obligations with its Municipal Advisor when issuing debt. Under normal circumstanced, the City will seek to limit its long-term net indebtedness (as described above) such that 75% of cumulative principal is repaid within ten years (short-term obligations and lease debt will be excluded from this calculation).

Selection of Term. For long-term obligations issued in the capital markets, water and sewer bonds generally will be structured to mature in 30 years or less. Projects issued through State or Federal programs will be structured to amortize in accordance to the permissible term that generates the largest advantage to the City, as determined by the COF.

Bond Structure Method. The LFL permits bonds to be amortized using the 50 Percent Rule or a level or declining debt structure. The COF shall select the amortization method that produces debt service payments compatible with the various affordability tests described in this section. The COF shall confer with the City's Municipal Advisor relating to the structuring of debt obligations.

Refinancing of Outstanding Bonds

The COF, with the assistance of the City's Municipal Advisor, shall periodically review the City's outstanding long-term debt to identify refunding opportunities. Except as noted, the City may refinance bonds, if the proposed transaction produces net present value savings equal to at least 3% [1] of the proposed refunding. However, the City may refinance bonds without regard to the 3 % threshold if its Common Council determines by resolution that there is a significant economic or other city interest served by such issuance.[2] Bonds may be refunded on a current or advance basis. Under the federal tax laws, the refunded bonds must be redeemed within 90 days for the refunding to qualify as a "current refunding". A current refunding is generally exempt from the arbitrage yield restrictions and rebate requirements. Under the Code, bonds are treated as advance refunding bonds when the original issue may not be redeemed within the 90-day limit. The Code, and the regulations promulgated thereunder, provide that bonds may be advance-refunded a single time over their life. Before proceeding with an advance-refunding, the City must consider if greater savings are possible by deferring the issuance of the refunding bonds.

The proceeds of advance refunding bonds are deposited to an escrow account and invested in U.S. Treasuries obligations. Debt service on the refunded bonds is paid from the escrow account until the redemption date. Federal tax laws restrict the yield on escrow investments to essentially the yield on the refunding bonds. The yield restriction creates "negative arbitrage" because the refunded bonds bear a higher interest rate than yield-restricted refunding bonds. This condition requires the issuance of additional bonds to properly fund the escrow in order to pay all amounts due. Whenever possible, the City shall seek to minimize the amount of "negative arbitrage" present in any advance refunding transaction. An unreasonably high amount of "negative arbitrage" may indicate higher savings may be available were the refunding to be postponed. The City's

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[1] The 3% threshold is commonly used by industry professionals as well as local government issuers of tax-exempt bonds as an efficiency test for potential bond refunding. A three to five percent savings threshold is noted in the "Best Practices Guide for State and Local Governments," published by the Government Finance Officers Association ("GFOA").

[2] GFOA Best Practices Guide discusses circumstances under which lower thresholds may be justified. Restoring equity balances in order to further financial stability goals would be a condition to consider lower levels of savings.

Municipal Advisor shall advise the COF whether the potential benefits outweigh the risks or costs of delaying the refunding.

The City may sell its refunding bonds by competitive bid or negotiation. Generally, the City will have some flexibility in timing the savings produced by a refunding. Savings may be evenly distributed over the life of the refunding or front-loaded with higher savings in the earlier years. The COF shall elect the refunding bond structure which results in the most favorable impact on the City's future operating budgets. For negotiated sales, underwriters should be selected after requests for proposals ("RFP") or qualifications ("RFQ"). Participation by women and minority underwriting firms is encouraged. The COF will select an underwriter or team of underwriters which the COF and the Municipal Advisor determine are able to underwrite the refunding bonds on the terms most favorable to the City. Underwriting fees will be considered but need not be the sole determining factor. Written proposals will be issued for the services of the bond escrow agent and escrow verification agent.

Federal Tax Law and Secondary Market Disclosure Compliance

The City adopted a post issuance compliance procedure and policy for its tax-exempt governmental bonds, last updated as of August 1, 2017. The document establishes a system of internal controls to ensure compliance with the various provisions of the Code as well as summarizing the City's covenants to provide secondary market information made pursuant to Rule 15-2c-12 of the Securities Exchange Act of 1934. The covenants themselves are in the more specific provisions of the continuing disclosure agreements applicable to each series of bonds. A copy of the post issuance compliance procedure and policy is attached hereto as Appendix A.

Credit Ratings and Relationships

As of the date of this policy, the City underlying rating with Moody's Investors Services is "Ba1," which is considered to be speculative or below investment grade by the investment community. A speculative rating has a significant impact on the City's ability to access the capital markets, the issuance costs associated with a debt sale, and the interest rate that is obtained. As such, the City is committed to restoring and maintaining an investment grade credit rating. However, credit rating strategies must not compromise the delivery of basic services to city residents.

Credit ratings can be influenced by a number of internal and external factors. The COF shall confer with the City's Municipal Advisor to understand such factors. Factors within the direct control of the City will be considered as a part of the City's annual budgeting process. In addition, whenever possible, the City will engage in short and long-term strategic planning efforts. Such plans will assist the COF in determining future risks and opportunities based on current assumptions. If credit risks are perceived in future years, the COF will be afforded ample time to develop a reactionary plan and to evaluate fiscal decisions.

The COF shall be responsible for maintaining relationships with rating agencies, which assign a rating to the City's debt. The COF will also confer with the City's Municipal Advisor regarding rating agency methodologies. Changes to current methodologies could impact future fiscal decisions.

Public Awareness and Transparency

This policy, and any amendments thereto which might be approved from time to time by the Common Council, shall be posted on the City's website. A printed copy shall be available in the Office of the Commissioner of Finance.

Dated: October 16th, 2017