Debt Management Policy

City of Santa Clara

City of Santa Clara
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CITY OF SANTA CLARA
DEBT MANAGEMENT POLICY

INTRODUCTION

This Debt Management Policy (the "Debt Policy") provides guidance for the issuance of bonds and other forms of indebtedness to finance land acquisition, construction, equipment, and other capital requirements of the City. While the issuance of debt is an appropriate method of financing capital projects and major equipment acquisitions, such issuance shall be carefully monitored to preserve the City's credit strength and to provide the necessary flexibility to fund future capital needs. In addition, the issuance of debt shall be closely aligned with the cash flow requirements of the projects being financed.

This Debt Policy shall conform to California Government Code section 8855(i) requiring any issuer of public debt to provide to the California Debt and Investment Advisory Commission (CDIAC), no later than thirty days prior to the sale of any debt, a report of the proposed issuance, including certification that the issuer has adopted local debt policies concerning the use of debt and that the proposed debt issuance is consistent with those policies.

AUTHORITY

The City of Santa Clara (the "City"), under the authority of the City Manager, executes debt instruments, oversees the accounting and reporting of debt, administers debt proceeds, manages continuing disclosure and debt compliance requirements, and makes debt service payments, while acting with prudence, diligence, and attention to prevailing economic conditions. The City Manager may delegate such authority to the Director of Finance.

The issuance of all debt shall receive required voter and/or City Council approval, and shall comply with all federal, state and local legal requirements.

SCOPE

This Debt Policy shall govern, except as otherwise covered by the City Charter and City Code, the issuance and management of all debt and lease financings funded in the capital markets. While adherence to the Debt Policy is required in applicable circumstances, the City recognizes that changes in the capital markets as well as unforeseen circumstances may from time to time produce situations that are not covered by the Debt Policy and may require modifications or exceptions to achieve City goals. As appropriate, the Director of Finance shall seek City Manager and/or City Council direction and approval.

OBJECTIVES

This Debt Policy will guide the City in determining appropriate uses of debt financing, establish certain debt management goals and assist the City in maintaining strong credit ratings, while assuming a prudent level of financial risk and preserving the City's flexibility to finance future capital programs and requirements. Additionally, this Debt Policy is intended to set forth criteria for selecting firms to provide certain financial, legal, and other services related to the issuance and subsequent monitoring and reporting of debt.

DEBT MANAGEMENT ACTIVITIES

The Finance Department shall be responsible for managing and coordinating all activities related to the issuance and administration of the City's debt and shall coordinate with other departments

on certain debt issuances, as needed. The Finance Department will assist other City departments with establishing and implementing debt-financed capital programs, as needed.

I. Debt Management Policy Review and Approval

This Policy shall be approved by the City Manager and adopted by resolution of the City Council. The Policy shall be reviewed annually by the Finance Department to insure its consistency with respect to the City's debt management objectives and any modifications must be approved by the City Manager and adopted by the City Council.

II. Debt Administration

The Finance Department shall have the responsibility and authority for structuring, implementing, and managing the City's debt and financing program, in accordance with City Council authorization.

The Finance Department shall oversee the City's debt management activities, including investment of bond proceeds, monitoring compliance with bond covenants, monitoring use of debt proceeds, monitoring use of facilities financed with tax-exempt debt, continuing disclosure, arbitrage compliance for tax-exempt debt, relationships with credit rating agencies, payment of debt service, and meeting all required federal, state, and local reporting requirements.

III. Reporting

Information regarding the City's outstanding debt is provided through the City's Comprehensive Annual Financial Report (CAFR), Stadium Authority Quarterly Financial Status Reports, Citywide Budget, and Stadium Authority Budget.

DEBT ISSUANCE

There are three general methods of issuing debt obligations, a competitive sale, negotiated sale and private placement.

I. Types of Bond Sales

A. Competitive Sale.
In a competitive sale, security dealers submit bids either in a sealed bid or electronically secure process and the security dealer with the lowest True Interest Cost (TIC) and in compliance with the bid parameters is awarded the bonds.

B. Negotiated Sale.
In a negotiated sale, an underwriter or underwriter syndicate is selected by the issuer. The interest rate and underwriter's fee are negotiated prior to the sale, based on market conditions. In the event a negotiated sale is used, the underwriter or underwriter syndicate will be selected by the Director of Finance.

C. Private Placement.
A private placement is the sale of an issue of debt to one or a limited number of buyers, such as a bank, insurance company or mutual fund, without a public offering. If the Director of Finance determines that it is in the best interest of the City from a cost or administrative standpoint, the Finance department may negotiate financing terms with banks and other financial institutions for specific borrowings ("private placements").

Private placements may be entered into in special circumstances where bonds may be difficult to market but may be attractive to a specific individual investor, to avoid the costs of a public offering and therefore reduce borrowing costs, or to secure financing quickly. All private placements shall be approved by the Director of Finance and the rationale for entering into such private placement shall be documented in writing.

The following Issuer Characteristics shall be considered to determine whether a competitive or negotiated sale will be used.

II. Issuer Characteristics

A. Market Familiarity. A frequent issuer of a well recognized credit such as general obligation bonds or revenue bonds can generally sell these bonds through a competitive sale since investors and underwriters are familiar with the quality of the credit. A negotiated sale may be appropriate if extensive pre-marketing to investors is desired or required.

B. Credit Strength. The higher the credit quality of the bonds being issued, the more likely the bonds can be sold using a competitive sale due to the high demand for high quality municipal bonds. High quality credits fare well in competitive sales.

C. Policy Goals. A competitive sale does not provide the City with the flexibility of choosing the underwriter or underwriter syndicate. If the Director of Finance concludes that determining the composition of the underwriter syndicate to achieve certain policy objectives is important, then a negotiated sale will be required. If the Director of Finance selects a negotiated sale solely for policy reasons then the specific rationale and criteria for selection should be clearly specified.

The following Financing Characteristics shall be considered to determine whether a competitive or negotiated sale will be used.

III. Financing Characteristics

A. Type of Debt Instrument. The market favors familiar debt instruments such as general obligation bonds backed by strong revenue streams. New credit types may require an education process that is more conducive to a negotiated sale until the market becomes comfortable with the credit.

B. Issue Size. The size of the bond sale will influence both investor interest in the bonds and the market's ability to absorb the bonds. In general, if the bond sale is too small or too large a negotiated sale may be necessary. A small sale may require greater marketing to garner investor interest while a large sale may be difficult for the market to absorb without the presale activity available in the negotiated sale process.

C. Market Conditions and Timing. During periods of stable interest rates, market timing is not as critical. However, during periods of volatile interest rates, the timing of the sale becomes more critical. Bond refundings are often very interest rate sensitive in terms of the potential level of savings or the general feasibility of the refunding. A negotiated sale provides more flexibility in terms of the structure and timing of the bond sale and may be more appropriate when issuing refunding bonds and when interest rates are volatile.

D. **Story Bonds.** Bonds that require a detailed explanation due to the complexity of the credit or the repayment of the bonds are often referred to as "Story Bonds". Due to their complexity and the additional explanation these bonds require, an extensive pre-marketing campaign is necessary. Story Bonds often require a negotiated sale composed of an underwriting syndicate that is qualified to market the bonds in order to obtain the lowest cost financing.

FINANCIAL SERVICE PROVIDERS

I. Selection

For negotiated sales, underwriters or underwriter syndicates will be selected by the Director of Finance. The allocation of bonds among syndicate members will be at the sole discretion of the Director of Finance. For competitive sales, any security dealer meeting the qualification criteria outlined in the competitive bid notice may bid on the competitive sale.

In connection with debt financings, financial advisors, bond counsel and other service providers shall be selected in accordance with the City's Municipal Code and City procurement standards. Contracts shall conform to the City Attorney approved contract standards and language.

II. Conflict of Interest

The City shall hire financial advisors who do not have a conflict of interest. In the event the best available financial advisor is an investment banking firm, the firm will under no circumstances be permitted to participate as the lead underwriter or as a member of an underwriter syndicate that is bidding on the bonds for which the firm is acting as a financial advisor. In addition, if the firm has any profit sharing or other type of agreement with any member of the underwriting syndicate for the transaction in question, they will not be allowed to act as the financial advisor. In general, no agreement will be permitted that would compromise the firm's ability to provide independent advice or that could be reasonably perceived by the City as a conflict of interest.

Advisors must alert the Director of Finance in writing, of any conflict, potential conflict, or potentially perceived conflict prior to entering into an agreement with the City, or if occurring after entering into an agreement with the City, as soon as the conflict, potential conflict, or potentially perceived conflict arises.

Pursuant to Rule G-37 of the Municipal Securities Rulemaking Board (MSRB), a firm may be banned from providing underwriting services to the City for two years for making any political contribution to an elected City official.

III. Communication

All financial consultants, including all investment banking firms, financial advisors, bond counsel, and other consultants hired in connection with any bond transaction will direct all communications, solicitations and questions to the Director of Finance or his/her designee.

ASSESSING FINANCING NEEDS FOR CAPITAL PROGRAMS

The five-year capital improvement program (CIP) of the City is approved by the City Council. The CIP shall provide the basis for determining long-term capital needs of the City and may be supplemented with longer term capital plans or master plans when appropriate. As necessary, the Finance Department shall work with the various City departments to develop financial forecasts related to the CIP to identify the optimal method to finance the program, including pay-as-you-go and/or the issuance of debt obligations. The Finance Department will work with other City departments, as applicable, in reviewing funding sources and financial forecasts to ensure their adequacy in complying with existing bond covenants, debt limits and any potential impact on existing bond ratings prior to the issuance of any new debt.

TAX STATUS

Prior to the issuance of any bonds, the Finance Department, in conjunction with bond counsel and the City Attorney's Office, will evaluate the tax status of the proposed bonds.

I. Tax-Exempt

Interest on the City's tax-exempt bonds is excluded from the gross income of its owners for federal income tax purposes and from California income taxes and as a result tax-exempt bonds can be sold at a lower interest cost than taxable bonds. The Finance Department, along with bond counsel, shall evaluate all projects contemplated to be debt financed to assess their eligibility to be funded by tax-exempt bonds. The City will make every effort to ensure that all tax regulations are complied with to ensure the bonds maintain their tax-exempt status.

II. Taxable

Certain municipal bonds are sold as taxable bonds because they are issued for purposes that the federal government deems do not provide a significant benefit to the public at large or involve "private activity". In addition, certain tax laws such as the alternative minimum tax (AMT) reduced the tax exemption applicable to certain types of bonds and to certain taxpayers. Taxable bonds may be used whenever a particular project has the potential for private activity or other uses that may call into question the eligibility to use tax-exempt financing.

TYPE OF DEBT

I. Fixed Rate Debt

Longer term debt usually consists of fixed interest rates over the term of the bonds and should be used to finance capital facilities and certain equipment where it is appropriate to spread the cost of the project over more than one budget year, but generally for a period not to exceed the useful life of the project being financed. In so doing, the City recognizes that future taxpayers who will benefit from the project will pay a share of its cost. Fixed rate debt provides the benefit of fixed payments during the life of the bonds and budget certainties for long-term capital planning. However, fixed rate debt is typically longer term and carries higher interest payments (assuming a normal interest rate environment/upward sloping yield curve) than variable rate debt but is not subject to changes in interest rates.

II. Variable Rate Debt

The municipal bond market has developed several vehicles by which municipalities can borrow at short-term, variable interest rates. Variable Rate Demand Notes may be issued with interest rates that "reset" daily, weekly, monthly or semiannually at the option of the issuer. Commercial paper is issued with a maturity of up to 270 days at the issuer's option. As the commercial paper matures, it is resold by a commercial paper dealer for another period up to 270 days.

These products are structured as a rolling series of short-term investments and therefore are priced at the short-end of the yield curve at lower interest rates than long-term fixed rate bonds (assuming a normal interest rate environment/upward sloping yield curve). Even with the risks inherent in variable interest rates, it may be prudent for the City to issue variable rate debt to take advantage of the lower interest rates.

Factors to be considered in the use of variable rate debt are the availability and size of fund balances to cover variable rate risk and the budget flexibility of the program being financed. Programs with large complex capital programs may use short-term financing to fund uncertain construction cash flow requirements. The short-term debt can be refinanced as long term, fixed-rate debt once the projects are complete. A project that must be carried in anticipation of grant funding may also be a candidate for the use of variable rate financing.

III. Use of Alternative Debt Instruments

A. Derivative Products: The use of certain derivative products, such as swaps and swaptions, allow the City to realize lower all-in costs on a new debt issuance or to receive an upfront payment. One type of swap that may be used allows the City to issue variable rate debt in exchange for fixed payments that are typically lower than fixed rate debt. However, such products have unique risks that the City and its financial advisors must evaluate per the City's Swap Guidelines. The current Swap Guidelines are included in Appendix A.

DEBT CAPACITY

In accordance with the City Charter Section 1309, the bonded indebtedness of the City may not in the aggregate exceed the sum of fifteen percent (15%) of the total assessed valuation of property within the City, exclusive of revenue bonds or any indebtedness that has been or may be incurred for the purposes of acquiring, constructing, extending, or maintaining municipally owned utilities, for which purposes a further indebtedness may be incurred by the issuance of bonds, subject only to the provisions of the State Constitution and the City Charter.

Within the limitations of City Charter Section 1309, determining the amount of indebtedness the City can afford begins by assessing the sufficiency of future revenues. The amount of debt issued is based on the requirements of the approved 5-year Capital Improvement Program, subject to the condition that sufficient revenues are projected to be available to pay debt service. Factors such as debt service coverage requirements outlined in the bond indentures, the impact on the citizens (tax rates), and any impact on the bond ratings will be carefully considered. Different factors are considered for each type of credit. For example, electric, water or sewer bonds will take into consideration the impact on customer utility rates. Other factors such as providing debt capacity for future programs and existing and forecasted fund balances, including reserves, will also be taken into consideration.

SECURITY OF DEBT

I. General Obligation (G.O.) Bonds

G.O. bonds are issued to fund the acquisition and improvement of real property and are usually issued at lower rates than other financing instruments due to their lower repayment risk. G.O. bonds are typically backed by ad valorem property taxes and require two-thirds voter approval to be issued by the City.

II. Revenue Bonds

Revenue bonds are supported solely from fees generated from specific Enterprise Funds. Accordingly, the City will issue revenue bonds when an identifiable revenue stream can be dedicated to support the payment of debt service. The final maturity of revenue bonds will be determined by the expected life of the project to be financed and the revenues available to repay the debt. Revenue bonds require majority voter approval in order to be issued by the City, except for revenue bonds issued to finance the generation, production transmission and distribution of electric energy, including the acquisition and/or construction of land and facilities therefore, which may be authorized by City Council.

III. Certificates of Participation (COPs) / Lease Revenue Bonds

Certificates of Participation are a debt instrument evidencing a pro-rata share in a specific pledged revenue source, usually lease payments. These lease payments are typically secured by an installment sale or leaseback agreement. Revenues are pledged to pay lease payments, and such lease payments are used to pay debt service on the COPs. The lessor typically assigns the lease and the payment to a trustee, which distributes the payments to certificate holders.

Payments to be made under valid leases are payable only in the year in which use and occupancy of the leased property is available, and lease payments may not be accelerated. Lease financing requires the fair market rental value of the leased property to be equal to or greater than the required debt service or lease payment schedule.

IV. State Revolving Fund Loans

The State of California administers various State Revolving Fund (SRF) programs to assist cities and other agencies with financing large capital projects. The programs function like an infrastructure bank by distributing low interest rate loans for projects. Loan repayments are recycled back into the SRF programs. Compared to traditional bond financing, the City may realize substantial savings as a result of the low interest rate of SRF loans.

The City's Finance Department, in conjunction with the benefitting department, shall request City Council approval to apply for SRF loans to finance capital projects when prudent to do so. The City may also apply for SRF loans with other cities or agencies to fund joint projects such as improvements to the San Jose/Santa Clara Regional Wastewater Facility.

Other State and Federal agencies such as the California Infrastructure and Economic Development Bank (I-Bank) and the United States Department of Transportation also provide low-cost loan programs to public agencies for a wide variety of public infrastructure projects including transportation, energy, and economic development projects. The Finance Department and benefiting departments within the City will evaluate such programs on a case by case basis.

V. Special Assessment Bonds

Special assessment bonds are a special type of municipal bond used to fund development projects that benefit a discrete group of taxpayers within a special assessment district. Principal and interest owed on the bonds is paid from assessments on the property benefiting from the particular bond-funded project. The creation of an improvement district is subject to approval of voters within the district and must follow a detailed legal process.

VI. Special District Bonds

Special Districts, including Community Facilities Districts (CFDs), are typically initiated by developers, whereby a developer seeks a public financing mechanism to fund public infrastructure required by the City in connection with a development. Special District bonds are issued and backed entirely by a special district established under State Statutes for the purpose of managing and financing public improvements within the district boundaries. The creation of a Special District must be approved by voters within the affected district and follow a detailed legal process. Subject to voter approval, once a district is formed special taxes or assessments may be levied upon properties within the district to pay for facilities and services directly, or to repay bonds issued to finance public improvements.

The City is required to provide on-going disclosure with respect to each Special District financing in conformance with federal and state laws, and must perform administrative work in connection with Special Districts. In its assessment of each application for Special District financing, consideration will be given to the additional work placed on the City's limited resources to administer these financings for the term of the bonds.

The formation of any CFD and the issuance of bonds secured by special taxes levied by a CFD shall be in accordance with the City's "Local Goals and Policies for Community Facilities Districts" adopted by City Council Resolution 10-7706 on March 30, 2010 (see Appendix C).

The City will consider requests for Special District formation and debt issuance when such requests address a public need or provide a public benefit. Each application will be considered on a case by case basis, and the Director of Finance may not recommend a financing if it is determined that the financing is not in the best interests of the City.

VII. Commercial Paper Notes

Commercial Paper Notes (CP) serve as a cash management tool that is primarily used to provide interim funding for capital expenditures that will ultimately be funded from another source such as long-term debt. CP will be used as a short term financing tool for only capital projects.

CP allows the City to borrow smaller amounts, as needed, at short term rates for up to 270 days in place of issuing large amounts in the form of long-term bonds at long-term interest rates. CP will typically be structured as revenue obligations for the City's enterprises or as lease revenue obligations for the City's General Fund capital needs, similar to long-term revenue bonds and lease revenue bonds. Upon maturity, CP may be rolled over for additional intervals of up to 270 days at new short-term interest rates, refinanced with long-term bonds or paid off with cash.

DEBT SERVICE RESERVE FUND

A debt service reserve fund for each debt issuance may be held by a bond trustee to make principal and interest payments to bondholders in the event that pledged revenues are insufficient to make the payments on a particular bond issuance. Investments held within a debt service reserve fund shall conform to the City's Investment Policy.

The maximum size of a reserve fund allowed under federal tax law, is the lesser of 1) 10% of the issuance amount (par); 2) 125% of average annual debt service; or 3) maximum annual debt service. The City shall have the option to issue debt with a debt service reserve fund that is less than the maximum allowable or without a reserve.

The Director of Finance shall have the authority to determine whether to establish a debt service reserve fund, the size of any debt service reserve fund, and the investments to be purchased within the reserve. Factors to consider include the cost of a debt service reserve fund over the life of the bonds compared to expected interest earnings, and bond pricing and credit rating impacts.

A debt service reserve may be funded with a surety policy when economically feasible, as determined by the Director of Finance.

PURPOSE OF FINANCING

Generally, debt may be issued to fund new projects ("new money financing") or to refund existing bonds.

I. New Money Financing

New money issues are financings that generate funding for capital projects. These funds will be used for necessary land acquisitions, capital construction, equipment, and other items for the City. New money bond proceeds are generally not used to fund operational activities.

II. Refunding Bonds

A periodic review of the City's outstanding debt will be performed by the Finance Department, or other delegated department, to identify potential refunding opportunities.

Refunding bonds are issued to retire all or a portion of an outstanding bond issue, typically to refinance at a lower interest rate and reduce debt service costs. Alternatively, a refunding transaction may be undertaken for reasons other than to achieve cost savings, such as to restructure debt service payments, to change the type of debt instruments being used, or to eliminate undesirable covenants.

In any event, a present value savings analysis shall be prepared that identifies the financial effects of any refunding being considered. The savings from any particular refunding candidate shall generally be at least 3% of the refunded par amount, net of all transaction expenses. This 3% savings target may be waived by the Director of Finance if he/she determines that the refunding is in the City's best overall financial interest and shall not be applicable for refunding transactions that are not solely undertaken to achieve cost savings.

CREDIT RATINGS

The City seeks to obtain and maintain the highest possible credit ratings for all categories of short- and long-term debt. The City will not issue bonds that do not carry investment grade ratings.

I. Rating Agency Relationships

The Finance Department shall be responsible for maintaining relationships with rating agencies that assign ratings to the City's various debt obligations. This responsibility shall include coordinating meetings and presentations in conjunction with the issuance of debt. Full disclosure of operations and open lines of communication shall be maintained with the rating agencies used by the City.

II. Use of Rating Agencies

A. The City shall obtain a rating from at least one nationally recognized rating agency on all new bond issues being sold in the public market. The Director of Finance shall determine whether or not any additional ratings will be requested on a particular financing. The Director of Finance shall determine which major rating agencies will be asked to provide a rating. Exceptions to this requirement, such as when using a private placement, are permissible, if warranted by the circumstances and approved by the Director of Finance.

B. The City shall notify the rating agencies when the City anticipates issuing bonds. Bond documentation shall be sent several weeks prior to the bond sale to the selected rating agencies in order to provide the rating agencies sufficient time to perform their review. A personal meeting with the selected rating agencies may be scheduled if, in the opinion of the Director of Finance such a meeting is in the best interest of the City in order to obtain the highest possible credit rating.

C. The City shall make every reasonable effort to maintain or improve its credit ratings.

D. The City shall request an underlying rating and an insured rating on all bond issues utilizing bond insurance or other credit enhancement instrument.

E. The City shall notify all rating agencies utilized by the City of any material financial events that occur within the City. All communications, both oral and written, in response to requests for information from the rating agencies shall be made in a timely manner.

F. The City shall submit its audited Comprehensive Annual Financial Report (CAFR) to all rating agencies utilized by the City.

CREDIT ENHANCEMENT

Credit enhancement through the use of bond insurance or a bank facility such as a letter of credit to strengthen the underlying credit rating of certain bonds may be financially beneficial. For example, bonds insured by insurers rated AAA will also receive the AAA rating and thus be able to be sold at a lower interest rate. Bank facilities, such as letters of credit from highly rated banks, can also be used to provide credit enhancement.

I. Bond Insurance

Bond insurance will be considered when it provides an economic benefit to a particular bond issue. Bond insurance provides improved credit quality for the bonds as a result of the

insurance provider's guarantee of the payment of principal and interest on the bonds. Because of the decreased risk of non-payment, investors are willing to purchase insured bonds at lower yields than uninsured bonds, thus providing the issuer with interest cost savings.

A. Benefit Analysis. The decision to use bond insurance is a financial decision. A benefit analysis compares the present value of the interest savings to the cost of the insurance. Insurance will be purchased when the premium cost is less than the present value of the projected interest savings. A copy of the benefit analysis shall be maintained in the files of the Finance Department.

B. Provider Selection. The City or its financial advisor will undertake a competitive selection process when soliciting pricing for bond insurance, or in the case of a competitive sale, facilitating the prequalification of bonds by insurance providers. The City recognizes that all providers may not be interested in providing bids to the City or pre-qualifying the issue. The winning security dealer in a competitive sale will determine whether it will purchase insurance for the issue. For a negotiated sale, the Director of Finance shall have the authority to purchase bond insurance when deemed advantageous and the terms and conditions governing the guarantee are satisfactory.

II. Bank Facilities (Letters of Credit)

When used for credit enhancement, letters of credit (LOC) represent a bank's promise to pay principal and interest when due for a defined period of time, subject to certain conditions. In the case of a direct-pay LOC, the trustee draws upon the LOC to make debt service payments and the City reimburses the LOC provider the amount drawn on the LOC by the trustee. A stand-by LOC is used to ensure the availability of funds to pay principal and interest of an obligation only if the funds in the debt service account held by the trustee are insufficient to make the debt service payment on the bonds.

STRUCTURAL FEATURES OF BOND ISSUANCE

I. Maturity

The final maturity of a bond issuance shall be equal to or less than the remaining useful life of the assets being financed.

II. Debt Service Structure

The City will carefully consider the debt service structure for each bond issue. Factors such as the flow of revenues available for a particular credit or the desire to structure savings from a refunding in a particular year shall be considered. Accelerated repayment may be considered within the bonding capacity constraints to provide capacity for future financings. A debt structure that is back loaded may be considered when such structuring is beneficial to the City's aggregate debt schedule or when such amortization more closely matches anticipated program cash flows.

III. Capitalized Interest

Subject to IRS regulations, interest on new money tax-exempt bonds may be capitalized during the construction period of a project, but may not be capitalized on refunding bond issues. Interest may also be capitalized on projects for which the revenue designated to pay

debt service on the bonds will be collected at a future date, until the facility is operational. Use of capitalized interest will require a review by bond counsel.

IV. Call Options/Redemption Provisions

The Director of Finance, or his/her designee, shall determine whether to issue debt with call options and the provisions of such call options such as call protection periods and call premiums. A call option, or optional redemption provision, provides the City the right to prepay debt prior to its stated maturity. Under certain market conditions, a call option allows the City to achieve future interest savings by refunding outstanding debt at lower interest rates. The City may also call outstanding bonds to alleviate undesirable bond covenants or to restructure debt service.

INVESTMENT OF BOND PROCEEDS

The City shall comply with all applicable Federal, State, and indenture restrictions, if any, regarding the use and investment of bond proceeds. This includes compliance with any restrictions on the types of investment securities allowed, restrictions on the allowable yield of invested funds as well as restrictions on the time period over which some bond proceeds may be invested. The Director of Finance, or his/her designee, will direct the investment of bond proceeds in accordance with the permitted investments for each particular bond issue. Investments such as guaranteed investment contracts may be considered when their use is in the best interest of the City and will be selected on a competitive basis.

CONTINUING DISCLOSURE

The City will comply with Rule 15(c)2-12 of the Securities and Exchange Commission, when applicable. The Finance Department shall be responsible for filing an annual report and annual financial information with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access System (EMMA) in a timely manner.

ARBITRAGE REBATE

Upon the issuance of tax-exempt bonds, the City shall not take any action that would cause the bonds to be declared "arbitrage bonds" within the meaning of the Internal Revenue Code of 1986 (the "Code"). Federal law states that investment earnings on tax-exempt bond proceeds in excess of the bond yield are arbitrage earnings and must be rebated to the Federal Government within certain prescribed timeframes, unless certain exceptions are met. Satisfying one or more of the exceptions may exempt a bond issue, or certain proceeds of a bond issue, from the rebate requirements. The Federal arbitrage regulations do not apply to taxable bond issues.

The City shall follow the procedures and guidelines set forth in the Code regarding the expenditure of proceeds, the investment of proceeds and applicable arbitrage rebate requirements (the "Arbitrage Regulations"). The Finance Department shall actively monitor the investment and disbursement of tax-exempt bond proceeds for compliance with the Arbitrage Regulations.

The Finance Department shall establish a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code. This effort shall include tracking project expenditures financed with bond proceeds, tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the City's outstanding tax-exempt debt issues. The City may enter into agreements with arbitrage service providers to assist the City with complying with arbitrage regulations.

POST ISSUANCE COMPLIANCE

The City shall comply with all applicable laws and regulations to ensure the tax-exempt status of its bonds and shall follow the procedures contained in Appendix B – Post Issuance Compliance Guidelines for Tax-Exempt Bonds.

APPENDIX A

INTEREST RATE SWAP AGREEMENT GUIDELINES
(the "Swap Guidelines")

These Swap Guidelines are promulgated by the City of Santa Clara (the "City") to govern the use of Interest Rate Swap Agreements. Interest Rate Swap Agreements shall be used judiciously and must be approved by the Director of Finance and City Manager, as detailed herein. "Interest Rate Swap Agreement" shall mean a written contract, entered into in connection with the issuance of debt by the City, in connection with City debt already outstanding or as a hedge for future anticipated debt, with a counterparty to provide for an exchange of payments based upon fixed and/or variable interest rates. "Swaps" shall be inclusive of Swaptions which are options on Swaps.

Conditions Under Which Interest Rate Swap Agreements May Be Entered

Purposes

Interest Rate Swap Agreements may be used for the following purposes only:

1. To achieve significant savings as compared to other, non-derivative type products available in the bond market,
2. To prudently hedge risk in the context of a particular financing or the overall asset/liability management of the City,
3. To incur variable rate exposure within prudent guidelines,
4. To achieve more flexibility in meeting overall financial objectives than available in conventional markets,
5. To accomplish a financial objective not otherwise obtainable using traditional financing methods (e.g., synthetic advance refundings of private activity bonds).

Legality

The City must receive an opinion acceptable to the market from a reputable law firm that the Interest Rate Swap Agreement is a legal, valid and binding obligation of the City and the transaction is not prohibited by any applicable law.

Speculation

Interest Rate Swap Agreements shall not be used for speculative purposes. Associated risks will be prudent risks that are appropriate for the City to take.

Methods By Which Such Contracts Shall Be Solicited And Procured

Generally, the City shall procure Interest Rate Swap Agreements by competitive bidding, with at least three firms solicited. The City shall determine which parties it will allow to participate in a competitive transaction taking into consideration, among other factors, the credit ratings of the swap counterparties. The City may procure Interest Rate Swap Agreements by negotiated methods if it makes a determination that, due to the size or complexity of a particular swap, a negotiated transaction would result in the most favorable pricing and terms or that doing so will promote its interests by encouraging and rewarding innovation. The City has the right to accept matching of bids in order to decrease counterparty risk. The City may obtain an independent opinion from a Swap Advisor that the terms and conditions of the Interest Rate Swap Agreement reflect a fair market value of such agreement as of the date of its execution.

Form and Content of Interest Rate Swap Agreements

To the extent possible, the Interest Rate Swap Agreements entered into by the City shall contain the terms and conditions set forth in the International Swap and Derivatives Association. Inc. ("ISDA") Master Agreement, including the schedule, credit support annex and confirmation. The schedule should be modified to reflect specific legal requirements and business terms desired by the City.

The City shall consider including provisions that permit the City to assign its rights and obligations under the Interest Rate Swap Agreement and to optionally terminate the agreement at its market value at any time. In general, the counterparty shall not have the right to optionally terminate an agreement.

The Agreement shall include the following events of default of a counterparty:

1. Failure to make payments when due,
2. Material breach of representations and warranties,
3. Illegality,
4. Failure to comply with downgrade provisions, and
5. Failure to comply with any other provisions of the agreement after a specified notice period.

The City shall have the right to terminate the agreement upon an event of default by the counterparty. Upon such termination, the counterparty will be the "affected party" for purposes of calculating the termination payment owed.

Aspects of Risk Exposure Associated with Such Contracts

Before entering into an Interest Rate Swap Agreement, the City shall evaluate all risks inherent in the transaction. The risks to be evaluated may include: counterparty risk, termination risk, rollover risk, basis risk, tax event risk, credit risk and amortization risk. The City shall endeavor to diversify its exposure to counterparties. To that end, before entering into a transaction, the City should determine its exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but rather how changes in interest rates would affect the City's exposure

"Value at Risk". The Value at Risk should be based on all outstanding derivative transactions of the City. Evaluation of risks will also include the following considerations:

1. Uncertainty with respect to the City's future debt obligations;
2. Effect on the City's credit quality;
3. Cumulative exposure to all risk factors identified;
4. Termination provisions of the swaps.

Counterparty Selection Criteria

The City may enter into an Interest Rate Swap Agreement if the counterparty or its guarantor has credit ratings of at least Aa3 from Moody's Investors Service and AA- from Standard & Poor's, and the counterparty has demonstrated experience in successfully executing Interest Rate Swap Agreements. If after entering into an agreement, the counterparty does not maintain the minimum ratings of Aa3/AA-, or as otherwise specified in the swap documents, then the agreement shall be subject to termination unless (a) the counterparty provides either a substitute guarantor or assigns the agreement, in either case, to a party meeting the rating criteria acceptable to the City, or (b) the counterparty (or guarantor) collateralizes the Interest Rate Swap Agreement in accordance with the criteria set forth in this Policy and the Interest Rate Swap Agreement. In addition, if after entering into an agreement, a rating of the counterparty is downgraded below Baa1/BBB+ or as otherwise specified in the swap documents, then the agreement shall be subject to termination unless the counterparty provides either a substitute guarantor or assigns the agreement, in either case, to a party meeting the rating criteria acceptable to the City.

Provisions for Collateralization

Should the rating of the counterparty, or if secured, the entity unconditionally guaranteeing its payment obligations, not satisfy the requirements of having at least two ratings of at least Aa3/AA-, then the obligations of the counterparty shall be fully and continuously collateralized by (1) direct obligations of the United States of America, (2) obligations of which the principal and interest are guaranteed by the United States of America, or (3) direct obligations of US Agencies and such collateral shall be deposited with the City or an agent thereof. Collateral requirements shall be subject to reasonable threshold and minimum transfer amounts. The specific collateralization requirements for each interest rate swap transaction shall be set forth in the corresponding swap documentation.

Long- Term Implications

In evaluating a particular transaction involving the use of Interest Rate Swap Agreements, the City shall review long-term implications associated with entering into Interest Rate Swap Agreements, including: cost of borrowing, historical interest rate trends, variable rate capacity, credit enhancement capacity, opportunities to refund related debt obligations, and other similar considerations. The required minimum present value savings to the City of a swap transaction issued to refund outstanding debt shall be at least twice the minimum required for a fixed rate refunding to compensate for the inherent risks associated with the use of interest rate swaps, unless it is determined by the Director of Finance that it is in the best financial interest of the City to accept present value savings of less than twice the requirement for a fixed rate refunding. Such determination shall be documented in writing.

Methods to Be Used to Reflect Such Contracts in the City's Financial Statements

The City shall reflect the use of Interest Rate Swap Agreements on its financial statements in accordance with generally accepted accounting principles, including the Governmental Accounting Standards Board pronouncements and guidance. Further, the City will provide appropriate swap disclosures to credit rating agencies, to investors in connection with bond offerings, and the municipal secondary market. Appropriate disclosure includes information about legal authority, risks, guidelines, and market value.

Monitoring

The City may use an independent Swap Advisor to assist internal professional staff in monitoring its existing or proposed swaps if it is in the best interests of the City to do so.

The City shall monitor its use of Interest Rate Swap Agreements on at least a semiannual basis as follows:

1. Preparing a description of each contract, including a summary of its terms and conditions, the notional amount, rates, maturity, and other provisions thereof;
2. Determining any amounts which were required to be paid and received, and that the amounts were paid and received;
3. Assessing the counterparty risk, termination risk, and other risks associated therewith, which shall include the aggregate mark to market value for each counterparty and relative exposure compared to other counterparties and a calculation of the City's Value at Risk for each counterparty;
4. Determining that each counterparty is in compliance with its rating requirements;
5. Determining that each counterparty is in compliance with the downgrade provisions, if applicable (See Counterparty Selection Criteria): and Determining that all posted collateral, if required, has a net market value of at least the collateral requirements specified in the Interest Rate Swap Agreement.

APPENDIX B

POST ISSUANCE COMPLIANCE GUIDELINES

The City has issued and may in the future issue obligations (including, without limitation, bonds, notes, loans, leases and certificates) that are subject to certain requirements under the Internal Revenue Code of 1986, as amended (the " IRS Code") and California Government Code Section 8855(i) (the "California Code").

The City has established the guidelines contained herein (the "Guidelines") in order to ensure that the City complies with the requirements of the IRS Code and California Code that are applicable to its bonds. These Guidelines, along with requirements contained in the Tax Exemption Certificate (the "Tax Certificate") and other documents executed at the time of issuance of debt, as well as the City's internal arbitrage procedures, are intended to constitute written Guidelines for ongoing compliance with Federal tax requirements and the California Code, as applicable, and for timely identification and remediation of violations, if any, of such requirements.

A. GENERAL MATTERS.

1. Responsible Officer. The Director of Finance shall have overall responsibility for ensuring that the ongoing requirements described in these Guidelines are met with respect to bonds (the "Responsible Officer").

2. Establishment of Guidelines. The Guidelines are included as a part of the City's Debt Management Policy.

3. Identify Additional Responsible Employees. The Responsible Officer shall identify any additional persons who will be responsible for each section of the Guidelines, notify the current holder of that office of the responsibilities, and provide that person a copy of the Guidelines (For each section of the Guidelines, this may be the Responsible Officer or another person who is assigned the particular responsibility.).

    a. Upon employee or officer transitions, new personnel shall be advised of responsibilities under the Guidelines and ensure they understand the importance of the Guidelines.

    b. If employee or officer positions are restructured or eliminated, responsibilities shall be reassigned as necessary to ensure that all guidelines have been appropriately assigned.

4. Training Required. The Responsible Officer and other responsible persons shall receive appropriate training that includes the review of contents of these Guidelines, review of the requirements contained in the IRS Code and California Code applicable to each bond, identification of all bonds that must be monitored, and familiarity with the actions that must be taken in order to correct noncompliance with the requirements of the IRS Code and California Code in a timely manner.

5. Periodic Review. The Responsible Officer or other responsible person shall periodically review compliance with the Guidelines to determine whether any violations have occurred so that such violations can be timely remedied through the "remedial action" regulations (Treasury Regulation §1.141-12, §1.142-2, §1.144-2, §1.145-2 or §1.147-2, as applicable) or the Voluntary Closing Agreement Program described in Internal Revenue Service ("IRS") Notice 2008-31 (or successor guidance) and related sections of the Internal Revenue Manual. Such review shall consist initially of compiling (a) a listing of fixed assets so financed, (b) a description of any sales or other dispositions of fixed assets so financed and (c) identifying any management contracts, lease or other use agreements discussed in Section D.3 hereof or amendments with respect to such agreements with private entities entered into (including, but not limited to agreements relating to solar energy or cellular phone towers) which have not been reviewed and approved by bond counsel as contemplated by Section D.3 hereof.

6. Change in Bond Terms. If changes to the terms of any bonds are contemplated, bond counsel shall be consulted. Such modifications could result in a reissuance (i.e., a deemed refunding of the bonds, which could jeopardize the tax-exempt status of the bonds, if applicable).

B. IRS INFORMATION RETURN FILING.

1. Filing of Applicable Form 8038. The Responsible Officer will confirm that bond counsel has filed the applicable information reports (such as Forms 8038 and 8038-G) with the IRS on a timely basis, and maintain copies of such reports, including evidence of timely filing as part of the transcript of the bond issue.

2. Filing of Forms 8038-T or 8038-R. The Responsible Officer shall file the IRS Form 8038-T relating to the payment of rebate or yield reduction payments in a timely manner. The Responsible Officer shall also monitor the extent to which the City is eligible to receive a refund of prior rebate payments and provide for the timely filing for such refunds using IRS Form 8038-R.

C. USE OF PROCEEDS. The Responsible Officer or other assigned personnel shall:

1. Use Consistent Accounting Guidelines. Maintain clear and consistent accounting guidelines for tracking the investment and expenditures of bond proceeds, including investment earnings on bond proceeds.

2. Monitor Reimbursement Allocations at Closing. At or shortly after closing of a bond issue, ensure that any allocations for reimbursement expenditures comply with the Tax Certificate.

3. Monitor Bond Proceeds. Monitor that sale proceeds and investment earnings on sale proceeds of tax-exempt bonds are spent in a timely fashion consistent with the requirements of the Tax Certificate. Maintain records identifying the assets or portion of assets that are financed or refinanced with proceeds of each issue of debt.

4. Monitor Costs of Issuance. With respect to qualified private activity bonds, monitor that no more than 2% of the sale proceeds are used to pay costs of issuance.

5. Qualified Use of Proceeds of Qualified Private Activity Bonds. With respect to qualified bonds, including exempt facility bonds, monitor that sale proceeds and investment earnings on sale proceeds are allocated to qualifying expenditures permitted for each type of qualified bond in a timely fashion consistent with the requirements of the Tax Certificate. If an exempt facility or other applicable facility will not be completed, or the facility has been placed in service, and there are remaining unspent bond proceeds, immediately consult with bond counsel to determine whether bonds are required to be redeemed under Treasury Regulation §1.142-2. If exempt facility bonds are required to be redeemed or defeased in order to comply with the remedial action rules under Treasury Regulation §1.142-2, such redemption or defeasance must occur within 90 days of the date an action is taken that causes the bonds to not be used for the qualifying purpose for which the bonds were issued.

6. Requisitions. Utilize requisitions to draw down bond proceeds. Review requisitions to ensure proper use of bond proceeds to minimize the need for reallocations. The Director of the department overseeing projects utilizing bond proceeds shall be responsible for ensuring that proceeds are used for their intended purpose and allocated to qualifying expenditures consistent with the Tax Certificate.

7. Final Allocation. Ensure that a final allocation of bond proceeds (including investment earnings) to qualifying expenditures is made if bond proceeds are to be allocated to project expenditures on a basis other than “direct tracing” (direct tracing means treating the bond proceeds as spent as shown in the accounting records for bond draws and project expenditures). An allocation other than on the basis of “direct tracing” is often made to reduce the private business use of bond proceeds that would otherwise result from “direct tracing” of proceeds to project expenditures. Bond counsel can assist with the final allocation of bond proceeds to project costs. Maintain a copy of the final allocation in the records of the bonds.

8. Maintenance and Retention of Records Relating to Proceeds. Maintain careful records of all project and other costs (e.g., costs of issuance, credit enhancement, and capitalized interest) and uses (e.g., deposits to a reserve fund) for which bond proceeds were spent or used. Records shall include a copy of all contracts and arrangements involving the use of debt-financed assets. These records should be maintained separately for each issue of bonds for the period indicated under Section E below.

D. MONITORING PRIVATE BUSINESS USE. With respect to tax-exempt bonds that are subject to the private activity bond limitations provided in the Code (e.g., governmental bonds and qualified 501(c)(3) bonds), the Responsible Officer, the Director of the department responsible for managing any asset financed with tax-exempt obligations, and any other responsible person shall:

1. Identify Bond-Financed Facilities. Identify the voter and/or City Council approval that approved each issue of bonds and the amounts and facilities financed.

2. Review Private Persons Contracts. Review all of the following contracts or arrangements with non-governmental persons or organizations or the federal government (collectively referred to as “private persons”) with respect to the bond-financed facilities which could result in private business use of the facilities:

   a. Sales of bond-financed facilities;

b. Leases of bond-financed facilities;

c. Management or service contracts relating to bond-financed facilities;

d. Research contracts under which a private person sponsors research in bond-financed facilities; and

e. Any other contracts involving "special legal entitlements" (such as naming rights or exclusive provider arrangements) granted to a private person with respect to bond-financed facilities.

3. Review New Contracts or Amendments with Bond Counsel. With respect to tax-exempt bond financed facilities, prior to amending an existing agreement with a private person or entering into any new lease, management, service, or research agreement with a private person, consult legal counsel to review such amendment or agreement to determine whether it results in private business use.

4. Analyze Use. Analyze any private business use of bond-financed facilities and, for each issue of bonds, determine whether the 10% limit on private business use (5% in the case of qualified 501(c)(3) bonds or "unrelated or disproportionate" private business use), as may be revised by the IRS, is exceeded, and contact bond counsel or other tax advisors if either of these limits appears to be exceeded.

5. Remediate if Limits Exceeded. If it appears that private business use limits have been exceeded, immediately consult with bond counsel to determine if remedial action is required with respect to nonqualified bonds of the issue under Treasury Regulation §1.141-12, or if the IRS should be contacted under its Voluntary Closing Agreement Program.

6. Retain Records Relating to Private Use. Retain copies of all of the above contracts or arrangements (or, if no written contract exists, detailed records of the contracts or arrangements) with private persons for the period indicated under Section E below.

E. RECORD RETENTION. The Responsible Officer or other responsible person shall ensure that for each issue of bonds, the transcript and all records and documents described in these Guidelines will be maintained while any of the bonds are outstanding and during the three-year period following the final maturity or redemption of that bond issue, or if the bonds are refunded, while any of the refunding bonds are outstanding and during the three-year period following the final maturity or redemption of the refunding bonds.

APPENDIX C

LOCAL GOALS AND POLICIES FOR COMMUNITY FACILITIES DISTRICTS

I. GENERAL.

Section 53312.7(a) of the California Government Code requires that the City of Santa Clara (the "City") consider and adopt local goals and policies concerning the use of the Mello-Roos Community Facilities Act of 1982, Section 53311 et seq. of the California Government Code (the "Act"), prior to the initiation of proceedings to establish a new community facilities district under the Act.

These Local Goals and Policies for Community Facilities Districts (these "Policies") provide guidance and conditions for the conduct by the City of proceedings for, and the issuance of bonds secured by special taxes levied in, a community facilities district (a "CFD") established under the Act. These Policies are intended to be general in nature; specific details will depend on the nature of each particular financing. These Policies are applicable to financings under the Act and are intended to comply with Section 53312.7 (a) of the Act. These Policies shall not apply to any assessment financing or any certificate of participation or similar financings involving leases of or security in public property. These Policies are subject to amendment by the City Council at any time.

II. FINANCING PRIORITIES.

Eligible Public Facilities. Except as provided below, the public improvements eligible to be financed by a CFD must be owned by a public agency and must have a useful life of at least five years Any development proposed within a CFD must be consistent with the City's general plan and must receive any required legislative approvals, such as zoning or specific plan approvals, prior to the issuance of bonds by the CFD to finance the acquisition or construction of public facilities. The formation of or issuance of bonds by a CFD shall not vest any rights to future land use on any properties, including those responsible for paying special taxes.

Eligible public facilities include, but are not limited to, the following:

- Streets
- Street lighting
- Traffic signals and safety lighting
- Landscaping on public property or in public easements
- Sanitary sewer facilities
- Storm drain facilities
- Flood control facilities
- Potable and reclaimed water facilities
- Utility improvements and relocations
- Elementary and secondary school sites and facilities
- Libraries
- Parks and recreational facilities
- Public utilities
- Cultural facilities
- Police and fire protection facilities
- Governmental facilities

- Parking lots and facilities
- Sidewalks, pedestrian pathways and pedestrian bridges
- Fencing

It is acknowledged that the Act permits the financing of fee obligations imposed by governmental agencies the proceeds of which fees are to be used to fund public capital improvements of the nature listed above. The City will consider an application to finance fee obligations on a case-by-case basis. The City will give priority to financing City fees because of the administrative burden associated with financing fees payable to other local agencies.

The funding of public facilities to be owned and operated by public agencies other than the City shall be considered on a case-by-case basis. If the proposed financing is consistent with a public facilities financing plan approved by the City, or the proposed facilities are otherwise consistent with approved land use plans for the property, the City shall consider entering into a joint community facilities agreement or joint powers authority in order to finance these facilities.

A CFD may also be formed for the purpose of refinancing any fixed special assessment or other governmental lien on property, to the extent permitted under the Act.

Priority Facilities. Priority for CFD financing of public facilities shall be given to public facilities which: (a) are necessary for development to proceed in an orderly fashion, or (b) are otherwise coordinated to correspond to the phasing of the related private development project. If appropriate, the City may prepare a public facilities financing plan as a part of the specific plan or other land use document that identifies the public facilities required to serve a project, and the type of financing to be utilized for each facility. The City will attempt to schedule construction of CFD-financed facilities in a manner such that private development will not occur ahead of the installation of public infrastructure necessary to support that development.

Eligible Services; Priority Services. The services eligible to be funded by a CFD are those identified in the Act. Subject to the conditions set forth in the Act, if applicable, priority for public services to be funded by a CFD shall be given to services which are (a) necessary for the public health, safety and welfare and (b) would otherwise be paid from the City's general fund. The City may fund services to be provided by another local agency if it determines the public convenience and necessity require it to do so, although the City prioritizes financing services to be provided by the City. If appropriate, the City may prepare a public services financing plan as a part of the specific plan or other land use document that identifies the public services required to serve a project and the source of funding for each such service.

Eligible Private Facilities. Financed improvements may be privately owned in the specific circumstances, and subject to the conditions, set forth in the Act.

III. BOND FINANCINGS; CREDIT QUALITY.

Value-to-Public Lien Ratio. At the time that a CFD issues a series of bonds, the value of the taxable property within the CFD should be at least three times the sum of (i) the principal amount of the bonds to be sold plus (ii) the pro rata principal amount of other outstanding publicly issued bonds that are secured by a special tax or assessment lien on the taxable property within the CFD; provided, however, that this requirement may be modified or waived pursuant to specific findings by the City Council as provided in Section 53345.8(b) or (c) of the Act. Property value may be based on either an appraisal (as described in VI below), or on assessed values as indicated on the last equalized County assessor's tax roll.

Development Status. The City will require all major land use approvals and governmental permits necessary for development of land in the CFD to be substantially in place before bonds are issued. The City may delay or disallow the formation of a CFD or sale of CFD bonds where a development project is on hold or other factors cause the City to determine that the development project's economic viability is uncertain.

Property Tax Delinquencies. The City may delay or disallow the formation of a CFD or sale of CFD bonds where property tax delinquencies exist with respect to the taxable property within the CFD.

Reserve Fund. In most cases, a debt service reserve fund will be required for CFD bond issues, which will be funded in an amount equal to the lesser of (i) 10% of the original proceeds of the CFD bond issue, (ii) the maximum annual debt service on the CFD bonds, or (iii) 125% of the average annual debt service on the CFD bonds. The City may agree to a smaller debt service reserve fund for CFDs for which certain development thresholds identified by the City have been met.

Failure to Meet Credit Criteria; Credit Enhancement; Escrow of Bond Proceeds. The City may consider exceptions to the credit quality criteria contained in these Policies for bond issues that do not represent an unusual credit risk, either due to credit enhancement or other reasons specified by the City, or which otherwise provide extraordinary public benefits, to the extent permitted by and subject to any applicable requirements of the Act.

If the City requires credit enhancement (in the form of a letter of credit, surety or other security), the credit enhancement shall be issued by an institution, in a form and upon terms and conditions satisfactory to the City. Any security required to be provided by the applicant may be discharged by the City upon satisfaction of the applicable credit criteria specified by the City.

As an alternative to providing other security, and subject to federal tax law, the applicant may request that a portion of the bond proceeds be placed in escrow with a trustee or fiscal agent in an amount sufficient to assure the financing will meet the applicable credit criteria, as determined by the City in its sole discretion. The escrowed proceeds shall be released at such times and in such amounts as may be necessary to assure the applicable credit criteria have been met.

Investor Suitability. The City will require that CFD bond financings be structured so that bonds are purchased and owned by suitable investors. In situations where the City determines that the credit quality of the CFD or the CFD bonds so warrant (for example, where there is an insufficient value-to-lien ratio, where a substantial amount of the property within a CFD is undeveloped, where tax delinquencies are present in parcels within the CFD, and in any other situation identified by the City), the City may require placement of bonds with a limited number of sophisticated investors, large bond denominations, or transfer restrictions.

IV. DISCLOSURES

Purchasers of Property. As a minimum, any disclosures mandated by applicable state law to inform prospective purchasers of their obligations under the CFD shall apply to each CFD. In addition, there may be additional requirements mandated by the City for particular kinds of financings on a case-by-case basis. The City may prescribe specific forms to be used to disclose the existence and extent of obligations imposed by CFD.

Disclosure Requirements for the Resale of Lots. The City shall provide a notice of special taxes to sellers of property (other than developers) which will enable them to comply with their notice requirements under Section 1102.6 of the California Civil Code. This notice shall be provided by the City within five working days of receiving a written request for the notice. A reasonable fee may be charged for providing the notice, not to exceed any maximum fee specified in the Act.

Continuing Bond Disclosure. The City may require landowners in a CFD that are responsible for 10% or more of the annual special taxes to provide: (i) initial disclosure at the time of issuance of any bonds; and (ii) annual disclosure as required under Rule 15c2-12 of the Securities Exchange Commission until the special tax obligation of the property owned by such owner drops below 10%.

V.EQUITY OF SPECIAL TAX FORMULAS AND MAXIMUM SPECIAL TAXES

Minimum Special Tax Levels. Special tax formulas shall provide for minimum special tax levels which satisfy the following payment obligations of a CFD: (a) 110 percent gross debt service coverage for all CFD bonded indebtedness, (b) the administrative expenses of the CFD, and (c) amounts equal to the differences between expected earnings on any escrow fund and the interest payments due on related bonds of the CFD.

In addition, the special tax formula may provide for the following to be included in the special tax levels: (a) any amounts required to establish or replenish any reserve fund established in association with the indebtedness of the CFD, (b) the accumulation of funds reasonably required for future debt service, (c) amounts equal to projected delinquencies of special tax payments, (d) the costs of remarketing, credit enhancement and liquidity facility fees, (e) the cost of acquisition, construction, rehabilitation, furnishing or equipping of authorized facilities, (f) lease payments for existing or future facilities, (g) costs associated with the release of funds from an escrow account, (h) the costs of authorized services, and (i) any other costs or payments permitted by law.

Equity of Special Tax Allocation Formula. The special tax formula shall be reasonable in allocating the CFD's payment obligations to parcels within the CFD. Exemptions from the special tax may be given to parcels which are publicly owned, held by a property owners' association, used for a public purpose such as open space or wetlands, affected by public utility easements making impractical their utilization for other than the purposes set forth in the easements, have insufficient value to support bonded indebtedness, or under other reasonable criteria set forth in the special tax formula.

Aggregate Tax Burden. The total projected property tax levels for any CFD (including ad valorem taxes, any maintenance, landscaping or other impositions on the land in the CFD and other similar annual government charges levied on parcels in the CFD, but excluding property owners' association annual levies and as to any special tax levies, based on the expected special tax rates and not any "back-up" special taxes) must be reasonable, and will be considered by the City on a case-by-case basis.

The annual increase, if any, in the maximum special tax for any parcel may not exceed any maximum specified in the Act. The increase in the special tax levied on any residential parcel as a consequence of delinquency or default by the owner of any other parcel may not exceed any maximum specified in the Act.

Levy on Entire Parcels. Special taxes will only be levied on an entire County assessor's parcel, and any allocation of special tax liability of a County assessor's parcel to leasehold or possessory interest in the fee ownership of such County assessor's parcel shall be the responsibility of the fee owner of such parcel and the City shall have no responsibility therefor and has no interest therein. Failure of the owner of any County assessor's parcel to pay or cause to be paid any special taxes in full when due shall subject the entire parcel to foreclosure in accordance with the Act.

Feasibility Analysis. The City may retain a special tax consultant to prepare a report which: (a) recommends a special tax for the proposed CFD, and (b) evaluates the special tax proposed to determine its ability to adequately fund identified public facilities, privately-owned improvements, City administrative costs, public services (if applicable) and other related expenditures. Such analysis, if prepared, will also address the resulting aggregate tax burden of all proposed special taxes plus existing special taxes, ad valorem taxes and assessments on the properties within the CFD.

VI. APPRAISALS

The definitions, standards and assumptions to be used for any appraisals shall be determined by City staff on a case-by-case basis, with input from City consultants, and by reference to relevant materials and information promulgated by the State of California (including, but not limited to, the California Debt and Investment Advisory Commission). The appraiser shall be an independent appraiser selected and retained by the City, and the appraisal shall be coordinated by and under the direction of the City.

The date of value referenced in the appraisal must be no more than 90 days before the date the bonds are priced, unless the City Council determines a longer time is appropriate.

All costs associated with the preparation of the appraisal report shall be paid by the applicant requesting the establishment of the CFD, if applicable, through an advance deposit.

VII. FINANCING TERMS

All terms and conditions of any CFD bonds shall be established by the City in its sole discretion. The City will control, manage and invest all proceeds of CFD bonds. Each CFD bond issue shall be structured (through the special tax levy, credit enhancements, foreclosure covenants, debt service reserve funds, or other measures) to adequately protect bond owners and to avoid any negative impact on the bonding capacity or credit rating of the City.

Neither the faith and credit nor the taxing power of the City will be pledged to security or repayment of any CFD bonds. The sole source of revenues that will be available to pay debt service on CFD bonds are special taxes, reserve funds or other pledged amounts held under the bond issuance documents, the proceeds of foreclosure proceedings for the collection of delinquent special taxes, and the proceeds of any additional security instruments or credit enhancements available to pay debt service on the CFD bonds.

The City shall, in its sole discretion, select and retain all consultants necessary for the formation of the CFD and the issuance of bonds, including one or more underwriters, bond counsel, disclosure counsel, financial advisors, the special tax consultant, and as applicable, an appraiser and market absorption/pricing consultant.

VIII. EXCEPTIONS TO THESE POLICIES

To the extent permitted by the Act, the City Council may waive or modify these Policies in any respect upon a finding that such a waiver or modification is reasonable or desirable under circumstances specific to a given CFD.

APPENDIX D

GLOSSARY OF DEBT MANAGEMENT TERMS

ADVANCE REFUNDING: A refinancing transaction whereby new (refunding) bonds are issued to repay (refund) outstanding bonds prior to the first call date. The proceeds of the refunding bonds are deposited in an escrow account, invested in government securities, and used to pay debt service (interest, principal and premium, if any) on the refunded bonds through the applicable call date. For accounting purposes, the refunded obligations are no longer considered outstanding bonds.

AMMORTIZATION: The planned reduction of a debt obligation according to a stated maturity or redemption schedule.

ARBITRAGE: Investment earnings representing the difference between interest paid on bonds and the interest earned on securities in which bond proceeds are invested. The Internal Revenue Code regulates the amount and conditions under which arbitrage on the investment of bond proceeds is permissible and the 1986 Tax Reform Act requires, with limited exceptions, that arbitrage earnings from investments be paid to the federal government.

BOND: Written evidence of the borrowing of money with the promise to repay principal, and usually interest, at a specified time.

BOND INSURANCE: Insurance supporting the timely payment of principal and interest of a bond in the event of failure by the issuer to pay principal and/or interest as promised. The cost of insurance is usually paid by the issuer, and should not be purchased unless the cost is more than offset by lower interest rates due to the insurance.

CALL: An action taken to pay the principal amount of bonds prior to their stated maturity date, in accordance with the bond provisions.

CALL PREMIUM: A dollar amount, usually stated as a percentage of the principal amount called, paid as a "penalty" or "premium" for the exercise of a call provision.

CALL PROVISIONS: The terms of the bond giving the issuer the right to redeem all or a portion of a bond issue prior to its stated date of maturity at a specific price, usually at or above par.

CAPITALIZED INTEREST: A portion of the proceeds of a bond issue which is set aside to pay interest on such bond issue for a specific period of time. Interest is commonly capitalized during the construction period of a debt financed project.

CERTIFICATE OF PARTICIPATION: A financial instrument representing a proportionate interest in payments such as lease payments by one party, such as a city acting as a lessee, to another party.

COMMERCIAL PAPER: A short-term, unsecured debt obligation issued with a stated maturity of up to 270 days.

COMPETITIVE SALE: A sale of bonds in which the bonds are awarded to the bidder who offers to purchase the bonds at the lowest cost via a sealed bid or electronic format.

CONTINUING DISCLOSURE: The requirement by the Securities and Exchange Commission to provide current financial information to the Municipal Securities Rulemaking Board (MSRB) for access by the public.

CURRENT REFUNDING: A refinancing transaction whereby new (refunding) bonds are issued to immediately repay (refund) outstanding bonds.

DEBT LIMIT: Statutory or constitutional limits on the principal amount of debt that an issuer may incur or may have outstanding at any one time.

DEBT SERVICE: Principal and/or interest payment on outstanding bonds.

DEBT SERVICE RESERVE FUND: A 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.

DISCOUNT: Amount (stated in dollars or a percent) by which the purchase price of a bond is less than its face amount.

GENERAL OBLIGATION DEBT: Bonds issued by a governmental entity and secured by the pledge of the full faith and credit and unlimited taxing power of the issuer.

LEGAL DEBT MARGIN: The amount of general obligation bonds that a municipality may have outstanding expressed as a percentage of the assessed value of real estate in the municipality as shown on the last preceding assessment of property taxes.

LEGAL OPINION: An opinion of bond counsel concerning the validity of a bond issue with respect to statutory authority, constitutionality, procedural conformity and the exemption of interest from federal income and state taxes, if applicable.

NEGOTIATED SALE: A sale of securities in which the terms of the sale are determined through negotiation between the issuer and the purchaser, typically an underwriter.

NET INTEREST COST (NIC): The average interest cost of a bond issue calculated based on the average coupon rate weighted to years of maturity, and adjusted for any original issue discount or premium.

OPTIONAL REDEMPTION: A right to retire a bond issue, or a portion thereof, prior to the stated maturity date. The exercise of an optional redemption may require the payment of a premium.

PAR VALUE: The principal amount of a bond due at maturity.

PRIVATE ACTIVITY BOND: A bond issued by a state or local government for the purpose of financing a project of one or more private users. Interest is not tax-exempt unless the use of proceeds meets certain requirements of the Internal Revenue Code.

PRIVATE PLACEMENT: The original placement of an issue with one or more investors as opposed to being publicly offered or sold.

REVENUE BOND: A bond secured by a specific source of revenue, such as a pledge of rates, rents, or fees.

TRUE INTEREST COST (TIC): A method of calculating the overall cost of a financing that takes into account the time value of money. The TIC is the rate of interest that will discount all future payments so that the sum of such payments equals the issue proceeds.

UNDERWRITER: A dealer that purchases new issues of municipal securities from an issuer and resells them to investors.

UNDERWRITER'S DISCOUNT: The difference between the price at which bonds are bought by an Underwriter from an issuer and the price at which they are reoffered to investors.