THE CITY OF SAN DIEGO

Report to the City Council

DATE ISSUED:	February 27, 2017	REPORT NO.	17-018
ATTENTION:	Council President and City Council		
SUBJECT:	Biennial Update of the City Debt Policy		

REQUESTED ACTION:

1. Adopt the biennial update of the City Debt Policy; and
2. Rescind Council Policy 100-12 "Industrial Development Bond Program."

STAFF RECOMMENDATION:

Approve the requested actions.

EXECUTIVE SUMMARY OF ITEM BACKGROUND:

The City Debt Policy was adopted in 2007 pursuant to Resolution No. R-303152 and has been subsequently reviewed by the City Council annually thereafter until April 2013, when a biennial review cycle was established via Resolution No. R-308090. This update represents the biennial review of the Debt Policy by the City Council since it was last approved on March 27, 2015 through Resolution No. R-309577.

I. Revisions to the Debt Policy are marked to reflect updates to the policy that was approved in March 2015 (see Attachment 1). The following represent the substantive recommended updates to the City Debt Policy.

1. **Added language reflecting adherence to Government Code Section 8855** *(See Debt Policy, Overview on page 2 and Section 9.5 on page 31).* The California Legislature adopted SB 1029 amending Government Code section 8855, effective January 1, 2017. Amendments to Government Code section 8855(i) require issuers to certify, prior to a bond issuance, that they have adopted local debt policies concerning the use of debt and that the proposed debt issuance is consistent with those policies. The revised Debt Policy outlines the elements a debt policy is required to include and specifies the City Debt Policy sections that satisfy each requirement. Additionally, effective for all bonds sales reported to the State after January 21, 2017, amendments to Government Code section 8855(k) require an annual debt transparency report, including information on debt authorized, debt outstanding, and the use and expenditure of bond proceeds during the reporting period.

2. **Update concerning use of Tax Allocation Bonds** *(See Debt Policy, Sections 3.6 page 9).* This update clarifies that the remaining use of Tax Allocation Bonds post dissolution of the Redevelopment Agency is limited for purposes of refunding Former Redevelopment Agency debt obligations.
3. **Added Enhanced Infrastructure Financing Districts** *(See Debt Policy, Section 3.9 on page 10).* This addition introduces Enhanced Infrastructure Financing Districts, which are a new California financing tool, made effective January 2015 through SB 628, that utilize tax increment to issue bonds to fund certain projects of communitywide significance.
4. **Update to the description of Industrial Development Bonds and removal of Council Policy 100-12** *(See Debt Policy, Section 3.10 on page 10 through 11).* This update expands upon Industrial Development Bonds in the Debt Policy and removes Council Policy 100-12 "Industrial Development Bond Program" from the Appendix. This removal takes into consideration that State law does not require the maintenance of a local policy for Industrial Development Bonds. Based on Economic Development Department recommendation, this update streamlines San Diego's approach towards the use of Industrial Development Bonds.
5. **Update to the description of the State Revolving Funds (SRFs)** *(See Debt Policy, Section 3.17 on page 13 through 14).* This update expands and generalizes this section to address all state and federal loans, not only SRFs. This update also reflects the departmental reorganization under which Debt Management serves as the coordinating department for all state and federal loans.
6. **Update to Chapter IV addressing debt ratio guidelines for General Fund Supported Debt** *(See Debt Policy, Section 4.2 page 16).* This update incorporates a new ratio to evaluate the impact that pension and retiree health care costs have on the General Fund. While pension and retiree health care costs and the City's annual contributions to meet these obligations are not controlled by the Debt Policy, these significant fixed costs need to be taken into account to calculate the overall debt burden on the General Fund and to evaluate the capacity for additional General Fund supported debt. Previously, only the level of annual debt service/lease payments was evaluated through ratio of annual debt service as a percentage of total available general revenues or expenditures (now referred to as Debt Ratio). No change has been made to the policy for this ratio, which states *the City shall strive to maintain a level below 10%.* The new ratio guideline, which incorporates pension and retiree health costs, is the Actuarially Determined Contribution (ADC) to the pension system and retiree health care (OPEB) annual contributions as a percentage of available general revenues or expenditures (referred to as Pension/OPEB Ratio). Taken together, the *City will strive to maintain the combined Debt Ratio and Pension/OPEB Ratio below 25%.*

II. In addition to the updates described above, Debt Management has confirmed with each applicable department or agency that the Debt Policy contains the most current version of the following Appendix items:

- Appendix B – San Diego Housing Commission Policy Multifamily Mortgage Revenue Bond Program (Housed with the San Diego Housing Commission and updated as of July 30, 2013)

- Appendix C – Council Policy 800-14 "Prioritizing CIP Projects" (Housed with the Public Works Department and updated as of November 13, 2013)
- Appendix E – Disclosure Practices Working Group – Disclosure Controls and Procedures (Housed with the City Attorney's Office and updated as of January 22, 2015)

III. Resolution R-303152, adopted in 2007, also specified that the City Debt Policy review include an update of developments in the financial markets, City's projected forward calendar of financings for the coming year, and schedules showing all outstanding debt obligations and other long term liabilities of the City and related entities. These topics are discussed below:

Municipal Debt Market Update

After tax-exempt rates reached historic lows in July 2016 combined with an expected pick up in Fed Fund rate hikes at the end of calendar year 2016, annual municipal bond issuance volume (new money and refundings) reached an all-time high in 2016 of $445 billion, a 12% increase over 2015. However, in the last quarter of 2016 and into early 2017, the tax-exempt market has shown signs of increased volatility while trending toward higher interest rates. Municipal Bond funds, typically the largest holder of municipal bonds after individuals, had enjoyed thirteen consecutive months of inflows beginning in October 2015 until they experienced their largest outflow since 2013, in late- 2016. The benchmark index for the municipal market, the Municipal Market Data Index (MMD), jumped by over 100 basis points (1%) from October to December 2016 before recovering slightly in January. The 30 year MMD rate as of mid-February 2017 was approximately 3.10% compared to mid-July 2016 when it hovered around 2%.

The current volatility is seen as a result of the confluence of conflicting and fluid expectations of the U.S. economy, policies of the new administration and global stability. Although the general consensus is for steadily increasing rates through 2017, as supported by the expectation for three additional rate hikes by the Federal Reserve due to improving US economic indicators, recent global political tensions and uncertainties are creating demand for the relative safety of US treasury bonds therefore keeping rate increases in check.

Since January 2016, the City conducted various bond offerings for new money needs and refundings to generate economic savings, which combined totaled approximately $1.7 billion. The categories included General Fund-backed lease revenue bonds, water and sewer revenue bonds, Successor Agency refunding bonds, and water utility commercial paper notes.

Municipal Regulatory Changes and Discussions in Calendar Year 2015 and 2016

Potential Tax Reform

Federal Tax reform is currently under discussion by President Trump's Administration and Congress. Key potential reforms that would affect the municipal bond market include the elimination of the tax exemption status on municipal bonds and reduction of corporate and individual tax rates. While the elimination of the tax exemption status on municipal bonds is generally seen as unlikely given statements made by President Trump and members of Congress in favor of maintaining the benefit and his goal to increase infrastructure spending, the implications of this reform, if enacted, would result in all state and local bonds being issued at significantly higher, taxable rates. More likely is the reduction of corporate and individual tax rates. This would likely have the result of increased tax-exempt borrowing rates (albeit still lower than taxable rates) as the attractiveness of the tax-exempt benefit to investors moderates. The magnitude of the increased tax-exempt borrowing rates will ultimately be dependent on the relative significance of the tax rate reductions and investor demand for municipal bonds.

Potential Deregulation of Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act, which went into effect in 2010, made several changes to the oversight of the municipal securities market. As most applicable to City and other municipal issuers, it required the registration of municipal advisors (i.e., financial advisors to states and local governments with respect to the issuance of municipal securities or the investment of bond proceeds) with the SEC, provided for their regulation by the Municipal Securities Rulemaking Board (MSRB), and included antifraud prohibition and imposed a fiduciary duty on municipal advisors (the "MA Rule"). The timing and scope of potential changes to the Dodd-Frank Act are currently unknown and any resulting impacts to the City and other municipal bond issuers are not quantifiable.

Forward Calendar – Loans and Bonds

SRF Loans

Debt Management is currently coordinating SRF loans for clean and drinking water projects. The Pump Station Two Power Reliability and Surge Protection Project loan totaling up to $56.2 million and 69th and Mohawk Pump Station loan totaling up to $18.8 million are both anticipated to be issued in March. In May, Debt Management expects a $10.7 million increase to the existing University Avenue Pipeline Replacement loan while the Advanced Metering Infrastructure loan of up to $42.0 million is anticipated to close in June.

Otay Mesa Enhanced Infrastructure Financing District (EIFD)

Debt Management is currently in the process of coordinating the creation of the Otay Mesa Enhanced Infrastructure Financing District to provide supplemental funding for infrastructure projects identified in the Otay Mesa Public Facilities Financing Plan. Under the current timeline, the district is expected to be created in July 2017, with a possible initial bond issuance totaling up to $14 million in Fiscal Year 2021.

Balboa Park Public Improvements

On November 14, 2016, City Council approved the issuance of bonds to help fund the capital improvements listed in the Balboa Park Plaza de Panama Project (R-310764). Listed among the improvements in the project, is a 797 space Parking Garage with a 2.2 acre rooftop park, a bypass bridge, and road to divert vehicular traffic away from the pedestrian core of the park. These bonds, totaling up to and amount not-to exceed $50 million, are expected to be issued in conjunction with the initiation of construction for the project, which is expected to be late-2017, following resolution of pending litigation.

General Fund CIP

The Five Year Outlook includes an estimated $270 million in financing proceeds for General Fund CIP between FY 2018 and FY 2022. The Finance Branch is evaluating CIP cash flow needs and expects establish a General Fund Commercial Paper program in Fiscal Year 2018. The actual size and timing of the comercial paper note issuance is to be determined.

Outstanding City Debt, Long Term Liabilities of the City and Related Entities, and Pension and Retiree Healthcare Costs

1. Outstanding City Debt Obligations

Attachment 2 is a summary of debt obligations consisting of General Fund Backed Lease-Revenue Obligations, and Wastewater and Water System Obligations.[1]

2. Debt without Government Commitment

Attachment 3 is Note 18 titled "Debt without Government Commitment from the Fiscal Year 2016 City of San Diego Comprehensive Annual Financial Report ("CAFR"). Note 18 provides outstanding long term liabilities of the City's Related Entities, including outstanding debt of the Special Assessment and Community Facilities (Mello-Roos) Districts established by the City, and outstanding debt of the City's former Redevelopment Agency.

3. Pension and Retiree Healthcare Costs

According to preliminary results of the June 30, 2016 Actuarial Valuation of SDCERS presented by Cheiron, Inc. to the SDCERS Board of Directors on January 13, 2017, the funded ratio (the actuarial value of assets available for benefits to total actuarial accrued liability) of the City's portion of the SDCERS fund was 71.6% and had an unfunded actuarial accrued liability ("UAAL") of $2.558 billion. The Citywide Fiscal Year 2018 Actuarially Determined Contribution ("ADC"), is $324.5 million if paid by the beginning of the year.

An actuarial valuation of the City's retiree healthcare (commonly referred to as "OPEB" for Other Post-Employment Benefits) program as of June 30, 2016, prepared by Buck Consultants dated as of September 16, 2016, in connection with compliance with GASB liabilities, indicates an UAAL of $537.8 million as of June 30, 2016. The Citywide retiree healthcare contribution in Fiscal Year 2018 is expected to be approximately $62.2 million.

FISCAL CONSIDERATIONS:

None specific to this action.

[1] Source: City of San Diego Annual Budget Fiscal Year 2017

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

On March 27, 2015, the City Debt Policy update was approved as reviewed and adopted by the City Council (R-309577).

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

All financing plans and bond issuances are developed consistent with the City Debt Policy recommendations, and any exceptions are identified in bond ordinances which are approved by the City Council.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

Not Applicable.

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Debt Management Director

Mary Lewis
Chief Financial Officer

Attachments:

1. City of San Diego Debt Policy, 2017 (Marked Copy)
2. City of San Diego Fiscal Year 2017 Adopted Budget, Summary of Debt Obligations
3. City of San Diego Comprehensive Annual Financial Report, for the Fiscal Year ended June 30, 2016 – Note 18, Debt without Government Commitment