Howard County, Maryland
Debt Management Policy

Department of Finance

3430 Court House Drive • Ellicott City, Maryland 21043 • (410) 313-2195 • (410) 313-4433

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Debt Management Policy

I. A. **Purpose:** The County recognizes the foundation of any well-managed debt program is a comprehensive debt policy. A debt policy sets forth the parameters for issuing debt and managing outstanding debt and provides guidance to decision makers regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, method of sale that may be used and structural features that may be incorporated. The debt policy should recognize a binding commitment to full and timely repayment of all debt as an intrinsic requirement for entry into the capital markets. Adherence to a debt policy helps to ensure that a government maintains a sound debt position and that credit quality is protected. From time to time, certain circumstances arise which could cause the Department of Finance to deviate from the policies herein. Advantages of a debt policy are as follows:

- enhances the quality of decisions by imposing order and discipline, and promoting consistency and continuity in decision making,
- rationalizes the decision-making process,
- identifies objectives for staff to implement,
- demonstrates a commitment to long-term financial planning objectives, and
- is regarded positively by the rating agencies in reviewing credit quality.

B. **Responsibility:** The Department of Finance is responsible for drafting this policy and incorporating comments from the County's Financial Advisor and Bond Counsel.

C. **Policy Updates:** The policy will be reviewed and updated (as needed) at least semi-annually.

D. **Definitions:** See Appendix A.

II. Spending Affordability Advisory Committee

A. **Purpose.** The Spending Affordability Advisory Committee was established by Executive Order in 1987 to provide recommendations and projections for the upcoming budget year. Specifically, the Committee is charged to review in detail the status and projections of revenues and expenditures for the County for the next

budget year and the subsequent 5 years; to evaluate future county revenue levels and consider the impact of economic indicators such as changes in personal income, assessable base growth, and other data which the Committee considers applicable; and to evaluate expenditure levels with consideration of the long-term obligations facing the County, and the best way to pay for them. The Committee recommends revenue projections and the amount of new County debt authorization for the upcoming fiscal year. The Committee report includes the effect its recommendations will have on future budgets and other findings and/or recommendations the Committee considers appropriate.

It is the task of this Committee to assess the County's ability to repay bond debt and the Committee issues an annual report defining debt capacity of the County. This review is an important element of the budget process and includes recommendations made by the Committee regarding how much new debt can be authorized by the County without over burdening itself with debt service payments.

B. **Members.** The Committee is composed of County citizens and government officials appointed by the County Executive.

C. **Debt Affordability Measures.** The Committee examines four statistical measures to determine debt capacity and compares these ratios to other counties, rating agency standards and Howard County's historical ratios to determine debt affordability. Only one of the measures is prescribed by Section 616 of the Howard County Charter, which provides that the County's debt cannot exceed 4.8% of the full cash value assessable base of the County. In order to determine the County's relative debt position, the Committee uses three additional measures:

1. **Debt measured against the population on a per-capita basis.** The County aims to maintain a level below the warning level of $1,200.00.

2. **Per-capita debt measured as a percent of the jurisdiction's per-capita personal income.** The Committee uses this measure in conjunction with measure number one, as this measure factors in the wealth not just the number of residents. The County aims to maintain a level below the warning level of 10.0%.

3. **Debt service as a percent of current revenues.** Ten percent or below is considered an appropriate level, with 15% and above as a danger point.

III. Comprehensive Capital Planning

A. Planning

1. **General Plan.** The Department of Planning and Zoning is responsible for the comprehensive planning of growth, development and conservation in the County. The department coordinates the preparation and revision of a general plan that includes policies for land use and land conservation and multi-year development plans for transportation, public facilities, water, sewerage, parkland, housing, human services and environmental protection.

2. **Master Plans.** Supporting the general plan are 10-year capital improvement master plans for transportation (roads, bridges and public transportation), water and sewer, solid waste, and schools which are updated annually. In addition to the requirements of the County Code, master plans are prepared by the Howard County Library and the Department of Recreation and Parks.

3. **Adequate public facilities.** The general plan guides where growth occurs, while the adequate public facilities process and standards manage growth so that facilities can be constructed in a timely manner. Adequate public facilities legislation requires the testing of proposed developments for adequacy of schools and roads as a condition of subdivision or site development plan approval. Milestones established in that legislation require properties to move in an orderly and predictable manner through the development process.

4. **Capital Improvement plan.** Sections 603 and 606 of the County's Charter require that the County prepare a multi-year capital program for consideration and adoption by the County Council as part of the County's budget process. Annually, the capital budget identifies revenue sources and expenditures for the coming current year and the next succeeding five fiscal years, as required by the Charter. The plan is updated annually.

5. **Effect on Future Operating Budgets.** Each capital project includes projections of the effect it will have on future operating budgets.

B. **Funding of the Capital Improvement Program.** Capital projects generally have a long useful life and will serve future taxpayers as well as current taxpayers. It is an inequitable and unreasonable fiscal burden to make current taxpayers fully pay for those projects out of the current tax revenues. This concept of taxpayer equity (those benefiting from a project should share in funding the cost of the project) is a consideration in how capital projects are funded. The County first attempts to fund capital projects with grants or developer contributions, then turns to several dedicated revenues that fund the capital program either as pay-as-you-go or to fund debt service. Dedicated revenues include transfer taxes, road excise taxes and school surcharge fees, water/sewer ad valorem fees and water/sewer front foot fees. If these are not available, the County will use excess surplus, general revenues, and bond financing. Water and sewer projects are solely funded by water and sewer charges and fees of the Enterprise Fund.

C. **Maintenance, Replacement and Renewal.** The County intends to set aside sufficient current revenues to finance ongoing maintenance needs and to provide periodic replacement and renewal. It is the County's philosophy to maintain safe and cost-effective buildings, maintain a sound working environment, preserve longevity of buildings and equipment, and protect public property and investment.

D. **Debt Authorization.** No County debt issued for the purpose of funding capital projects may be authorized by the County Council unless an appropriation has been included in the capital budget.

IV. Planning and Structure of County Indebtedness

A. **Overview.** The County plans long- and short-term debt issuance to finance its capital program based on its cash flow needs, sources of revenue, capital construction periods, available financing instruments and market conditions. The Director of Finance oversees and coordinates the timing, issuance process and marketing of the County's borrowing and capital funding activities required in support of the capital improvement plan.

The County finances its capital needs on a regular basis dictated by its capital spending pattern. The County monitors market conditions and takes advantage of refinancing opportunities to reduce its interest cost as far as practicable.

B. **Financing Team.** The County employs outside financial consultants to assist in developing a bond issuance strategy, preparing bond documents and marketing bonds to investors. The key players in the County's financing transactions include its financial advisor and bond counsel, the underwriter (on a negotiated sale) and County representatives (the Director of Finance and the Budget Administrator, among others). Other outside firms, such as those providing paying agent/registrar, trustee, credit enhancement, auditing, or printing services, are retained as required.

The financing team meets annually to review the overall financing strategy of the County for the upcoming year.

C. **Overlapping Debt.** There are no incorporated towns, villages, municipalities or other subdivisions within the County boundaries having separate taxing authority. Thus, there is no overlapping municipal debt in the County.

D. **Term of Debt Repayment.** The County follows guidelines set by Section 11 of Article 31 of the Annotated Code of Maryland, as amended and Section 617 of the Howard County Charter. Borrowings by the County mature over a term that does not exceed the economic life of the improvements that they finance. The County consolidates its long-lived municipal improvements into Consolidated Public Improvement Bonds (with a maximum term of 20 years) and its long-lived sewer and water system improvements into Metropolitan District Bonds (with a maximum term of 30 years).

The County does not finance improvements with a probable useful life less than four years, using pay-go funding for such needs. Consolidated Public Improvement (CPI) Bonds sold for the purchase of equipment with a probable useful life exceeding three years are repaid over a term that does not exceed such useful life. The County generally finances such short-lived improvements as part of its CPI bonds rather than with leases, in order to finance such improvements at the lowest possible cost.

E. **Legal Borrowing Limitations.**

1. **Bonds and other indebtedness.** As stated in Section 616 of the Howard County Charter, the total amount of bonds and other indebtedness outstanding shall not exceed 4.8% of the full cash value assessable base of the County, excluding:

a. Tax anticipation notes and other indebtedness with a maturity of one year or less;

b. Bonds or other indebtedness of the County payable from taxes levied from special taxing areas; and

c. Self-supporting bonds or other debt.

F. **Bond Features.** The Consolidated Public Improvement Bonds and the Metropolitan District Bonds are general obligations of the County, and its full faith and credit and unlimited taxing power are irrevocably pledged to the punctual payment of principal of and interest on such bonds when due and payable. Principal is payable in installments, the first of which is payable within two years of the date of issue.

1. **Original issue discount or premium.** The County's bonds may be sold at a discount or premium, in order to market its bonds more effectively, achieve interest cost savings or meet other financing objectives. The maximum permitted discount is stated in the Notice of Sale accompanying the County's preliminary official statement.

2. **Debt Service Structure.**

a. **Consolidated Public Improvement Bonds.** Although the County finances its long-lived municipal improvements over a 20-year term, the County generally structures the principal repayments on these bonds such that their weighted average maturity approximates 11¾ years. This rapid amortization results in over 60% of the County's consolidated public improvement debt being repaid within ten years. This policy minimizes the interest payments made over time, and causes the rating agencies to look more favorably on the County's debt structure. The County will seek to continue this practice, unless general fund revenues are projected to be insufficient to fund debt service payments on necessary debt.

b. **Metropolitan District Bonds.** The County finances its long-lived water and sewer improvements over a maximum 30-year term, and generally structures the principal repayments on these bonds such that the annual debt service (principal and interest) payments are approximately equal for each year such bonds are outstanding. This amortization policy results in over 55% of the County's metropolitan district bonds being repaid within ten years. Because of the long-lived nature of sewer and water system improvements, this policy still allows for amortization of debt prior to the time when such improvements need to be replaced.

c. **Tax Increment Financing Bonds.** All Tax Increment Financing Bonds ("TIF Bonds") will be approved in accordance with Title 12, Subtitle 2 of the Economic Development Article of the Annotated Code of Maryland (the Tax Increment Financing Act) and Section 9-1301 of Article 24 of the Annotated Code of Maryland (regarding Special Taxing Districts). Applications for TIF Bonds will be reviewed by the Tax Increment Financing Committee and a recommendation will be made to the County Executive. All applications will include a financial analysis which indicates that the total incremental tax revenues generated by the

development exceed the annual debt service on the bonds. The applicant will be responsible for costs of a consultant's review of the financial analysis and outside bond counsel. An annual report on revenues collected to service debt requirements is required.

In most cases a companion Special Tax District will be established to authorize the collection of Special Taxes to supplement the TIF District tax increment as needed to meet debt service obligations. Any TIF Bonds issued will not constitute a pledge of the full faith and credit or taxing power of the County and the County will not be obligated to pay the debt service except from tax increment or special tax monies deposited in a special tax district fund.

3. **Call provisions.** The County seeks to balance the protection from optional redemption given to bondholders, with its desire to obtain the lowest possible interest rates on its bonds. The County's bonds are generally subject to optional redemption. The County seeks early calls at low or no premiums because such features have allowed it in the past to refinance debt more easily for debt service savings when interest rates dropped. The County and its financial advisor evaluate optional redemption provisions for each issue to assure that the County does not pay unacceptably higher interest rates to obtain such advantageous calls.

4. **Interest rates.** The County uses variable or fixed-rate debt to finance its capital needs. The County's policy is to limit the amount of long-term variable rate debt to 20% of the County's total outstanding consolidated public improvement or metropolitan district general obligation debt (whichever is applicable).

5. **Capitalized Interest.** Capitalized interest increases the amount of debt to be issued and therefore will be avoided unless beneficial from a credit standpoint, as in the case of lease-purchase obligations. Interest on General Obligation Bonds will not be capitalized. Interest may be capitalized on TIF Bonds.

G. **Installment Purchase Agreements.** The County may enter into installment purchase agreements pursuant to Section 4.201A of the Howard County Code to acquire land in fee simple provided that the present value of the installment purchase agreement payments is less than the appraised value of the acquired land by an amount that provides a significant economic benefit to the County.

H. **Other Debt.** The County has an agricultural land preservation program that enables it to purchase (extinguish) development rights on farmland in the County. The financing for this program complies with all County statutory requirements pertinent to bonds and Title 15, Subtitle 5 of the County Code relating to Agricultural Land Preservation. An individual easement can be purchased from a landowner using (1) an installment purchase agreement that pays interest semi-annually, small amounts of principal biennially and the bulk of the principal at the end of 30 years; (2) an installment purchase agreement paying equal amounts of principal for up to 30 years and interest on the outstanding principal balance; or (3) a cash down payment in combination with an installment purchase agreement. The final principal payment for the first option is paid from the proceeds of stripped U.S. Treasury bonds, known as "zeros," maturing on the appropriate date. The program is fully funded by an allocation from the transfer tax

revenues. A spending affordability analysis, which is updated annually, is used to determine how many preservation easements can be purchased.

I. **Lease Debt.** The County will use lease financing when it is economic and efficient. For example, the County enters into Energy Savings Contracts where the lease payments are fully funded by future savings in utility costs.

J. **Other Obligations Classified as Debt.**

1. **Vested vacation benefits.** Vacation benefits are earned by County employees based on time in service, and the rights to such benefits are vested. The County records vested vacation benefits as earned in accordance with generally accepted accounting principles. In the Governmental Funds, only the amount owed to former employees at year end is accrued as an expense and recorded as a liability. The total liability related to the Enterprise Fund is accrued as an expense and liability in that fund. The amount of vested vacation benefits is not included in measures used to evaluate the County's debt affordability.

2. **Landfill closure and post closure care cost.** State and federal laws and regulations require the County to cover its landfill cells when filled and to monitor and maintain such cells for 30 years after closure. The County recognizes a portion of these costs in each operating period based on estimated landfill capacity used as of each balance sheet date. The amount of accrued landfill closure costs is not included in measures used to evaluate the County's debt affordability until such costs are actually paid from proceeds of bonds.

V. Bond Anticipation Notes (Section 12 of Article 31 of the Annotated Code of Maryland)

A. **Construction Financing.** The County may issue fixed- or variable-rate bond anticipation notes (BANs), when their use is judged to be prudent and advantageous. The County may elect to use BANs to provide interim construction financing for its capital improvement program as a method of managing its available cash. BANs may be sold in either a competitive or negotiated sale, subject to prior authorization by the County Council. The maximum BAN amount of construction financing is limited to the estimated construction cost of capital projects during a two year period.

B. **Credit or Liquidity Enhancement.** The County may seek to use credit or liquidity enhancement when such enhancement proves to be cost-effective or to improve or establish a credit rating on BANs. Selection of an enhancement provider is subject to an evaluation process developed by the underwriter and financial advisor and approved by the Director of Finance. Criteria to be used in selecting an enhancement provider include:

1. the short- and long-term credit ratings of the institution;
2. the relative trading level of debt supported by the enhancement provider;
3. the institution's experience with providing credit or liquidity facilities to municipal bond issuers;
4. competitiveness of fees, interest charged on liquidity draws and maximum legal and administrative fees;

5. ability to agree to state and county legal requirements including providing an annual financial report and prompt notification of any credit rating downgrades; and
6. the amount and number of liquidity facilities currently outstanding in the market.

VI. Method of Sale

The County will select a method of sale that is the most appropriate in light of financial, market, transaction-specific and other conditions. The County will comply with requirements of Section 616 of the Howard County Charter.

A. Competitive Sales. Long-term bonds are generally issued through a competitive sale. The County and its financial advisor will set the terms of the sale to encourage as many bidders as possible. By maximizing bidding, the County seeks to obtain the lowest possible interest rates on its bonds. Some of the conditions that generally favor a competitive sale include:

1. the market is familiar with the County;
2. the County is a stable and regular borrower in the public market;
3. there is an active secondary market with a broad investor base for the County's bonds;
4. County bonds have a non-enhanced credit rating of A or above or can obtain a credit enhancement prior to the competitive sale;
5. the debt structure is backed by the County's full faith and credit or a strong, known or historically performing revenue stream;
6. the issue is neither too large to be easily absorbed by the market nor too small to attract investors without a concerted sale effort;
7. the issue does not include complex or innovative features or require explanation as to the bonds' security;
8. the issue can be sold and closed on a schedule that does not need to be accelerated or shortened for market or policy reasons; and
9. interest rates are stable, market demand is strong, and the market is able to absorb a reasonable amount of buying or selling at reasonable price changes.

B. Negotiated Sales. When certain conditions favorable for a competitive sale do not exist and when a negotiated sale will provide significant benefits to the County that would not be achieved through a competitive sale, the County may elect to sell its debt obligations through a private or negotiated sale, as authorized by ordinance enacted by the County Council. Such determination may be made on an issue-by-issue basis, for a series of issues, or for part or all of a specific financing program. The underwriting team is selected through a competitive process. The following practices are observed in the event of a negotiated sale:

1. ensure fairness by using a competitive underwriter selection process through a request for proposals where multiple proposals are considered;
2. remain actively involved in each step of the negotiation and sale processes to uphold the public trust;
3. ensure that either an employee of the County, or the financial advisor, who is familiar with and abreast of the condition of the municipal market, is available to assist in structuring the issue, pricing, and monitoring sales activities;

4. require that the financial advisor not act as underwriter;
5. require that financial professionals disclose the name or names of any person or firm, including attorneys, lobbyists and public relations professionals compensated in connection with a bond issue;
6. request all financial professionals submitting joint proposals or intending to enter into joint accounts or any fee-splitting arrangements in connection with a bond issue to fully disclose to the County any plan or arrangements to share tasks, responsibilities and fees earned, and disclose the financial professionals with whom the sharing is proposed, the method used to calculate the fees to be earned, and any changes thereto.

VII. Refinancing of Outstanding Debt. The Internal Revenue Code states that government bonds issued after 1985 may only be advance refunded once. Section 24 of Article 31 of the Annotated Code of Maryland authorizes refinancing of any County Bonds. The County may undertake refinancing of outstanding debt under the following circumstances:

A. Debt Service Savings. The County may refinance outstanding long-term debt when such refinancing allows the County to realize significant debt service savings without lengthening the term of refinanced debt and without increasing debt service in any subsequent fiscal year. A review of potential savings is performed annually.

B. Defeasance. The County may refinance outstanding debt, either by advance refunding to the first call or by defeasance to maturity, when the public policy benefits of replacing such debt outweigh the costs associated with new issuance as well as any increase in annual debt service.

VIII. Conduit Financings

Conduit financing are securities issued by a government agency to finance a project of a third party, such as a non-profit 501(c) (3) organization or other private entity. The County may sponsor conduit financings for those activities (e.g., economic development, housing, volunteer fire departments) that have a general public purpose and are consistent with the County's overall service and policy objectives.

The County will require such third parties to provide such information to the County as the County deems appropriate or necessary, including the provision of annual financial statements. Existing conduit financings do not in any way pledge the County's faith and credit. The County is not restricted from utilizing new conduit debt financing programs sponsored by the Federal or State governments that require a pledge of the full faith and credit of the County.

IX. Derivatives

No derivative products will be utilized unless permitted by law or without prior authorization of the County Council. No derivative products shall be utilized without an analysis by an independent financial advisor and the implementation of an independent monitoring program. Prior to entering into any swap or derivative transaction, the County will develop a