King County

KING COUNTY

1200 King County Courthouse
516 Third Avenue
Seattle, WA 98104

Signature Report

December 17, 2007

Motion 12660

Proposed No. 2007-0582.2 **Sponsors** Ferguson

1 A MOTION adopting a Debt Management Policy for King
2 County.
3
4 WHEREAS, King County is one of the largest municipal issuers of debt in the
5 nation and has a long history of achieving exemplary bond ratings because of sound and
6 prudent financial management and debt issuance practices, and
7 WHEREAS, the county recognizes the need to have a formal adopted debt
8 management policy that primarily adopts past decisions and practices while also
9 providing new opportunities to lower the cost of borrowing and reduce exposure to
10 changes in interest rates, and
11 WHEREAS, RCW 36.48.070 requires the adoption of a debt policy by counties
12 within the state of Washington, and
13 WHEREAS, at least one of the credit rating agencies has identified that an
14 adopted debt policy would be an additional positive factor in its credit rating of the
15 county, and
16 WHEREAS, the Debt Management Policy has been reviewed and endorsed by
17 the members of the King County financial policies advisory task force, which was created

18 by Motion 12394 and charged with the duties of reviewing the county's financial and debt

19 policies, examining best practices and making recommendations to the council;

20 NOW THEREFORE, BE IT MOVED by the Council of King County:

21 A. The King County Debt Management Policy, Attachment A to this motion, is

22 hereby adopted.

23 B. The executive finance committee will be responsible for periodically

24 considering amendments to the Debt Management Policy and for submitting changes to

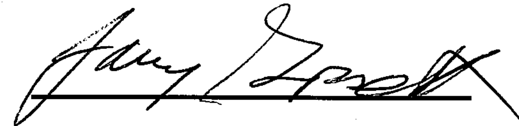
25 the executive and council for approval.

26

Motion 12660 was introduced on 11/5/2007 and passed by the Metropolitan King County Council on 12/17/2007, by the following vote:

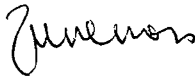
Yes: 8 - Mr. Gossett, Ms. Patterson, Ms. Lambert, Mr. von Reichbauer, Mr. Dunn, Mr. Ferguson, Mr. Phillips and Mr. Constantine
No: 0
Excused: 1 - Ms. Hague

KING COUNTY COUNCIL
KING COUNTY, WASHINGTON



Larry Gossett, Chair

ATTEST:



Anne Noris, Clerk of the Council

Attachments A. King County Management Policy dated 12-12-07

King County Debt Management Policy

1.0 Introduction

This document sets forth the policies that will govern the issuance and management of debt by King County (hereinafter the "county"). This Debt Management Policy is being developed for two reasons. First, it would satisfy the requirements of RCW 36.48.070. Second, the credit rating agencies have identified the adoption of a formal debt policy as a source of rating strength.

This policy does not replace an existing county comprehensive debt policy and, with the exception of authorizing the county to use payment agreements, does not represent any significant departures from existing debt management practices. Illustrative examples of past policy decisions and practices are noted throughout the policy.

It is intended that this policy, and periodic future amendments, will be adopted by the King County Council (hereinafter the "council"). Periodic amendments will be reviewed by the county's Executive Finance Committee (hereinafter the "EFC") and recommended changes will be submitted to the Executive and County Council for approval.

This policy does not address the amount of debt that can be prudently issued on behalf of the different funds of the county. The subject of prudent debt levels and borrowing strategies, which will depend on factors such as the stability of their revenue streams, should be addressed by the financial policies and plans for each of these Funds.

2.0 Policy Goals

The county's debt will be managed with an overall philosophy of taking a long-term approach to borrowing funds at the lowest possible cost, consistent with an acceptable level of risk.

The county's debt management practices are intended to achieve the following specific objectives:

- To minimize debt service costs, subject to preserving the county's flexibility to provide services and set rates and charges.
- To limit the exposure of the different funds of the county to interest rate risk and other risks to levels commensurate with their ability to absorb such risk.
- To preserve adequate capacity for the county to finance future capital needs with low-cost debt.
- To contribute to the maintenance or enhancement of the county's current very strong bond ratings.

3.0 Roles & Responsibilities in the Debt Issuance Process

3.1 King County Council
The council is responsible for the adoption of legislation necessary for the issuance of all county debt.

3.2 Finance and Business Operations Division
The Finance and Business Operations Division (hereinafter the "Division") within the Department of Executive Services is responsible for identifying potential borrowing strategies, coordinating all of the work necessary for the issuance of such debt, and for subsequent administration.

3.3 King County Agencies
Individual agencies, working through the Office of Management and Budget (hereinafter the "OMB"), are responsible for providing adequate advance notification of the need for borrowing and for providing information as requested by the Division needed for the issuance and administration of such debt.

3.4 Executive Finance Committee
The EFC is responsible for periodically reviewing the debt management policy and recommending any policy changes to the Executive and County Council for approval. The EFC also has the authority to clarify the intent of the approved policy and practices, as needed.

4.0 Type of Debt Instruments

4.1 Bonds
The great majority of the debt issued by the county will take the form of fixed rate municipal bonds with terms ranging between 3 and 40 years to finance capital assets.

4.2 Notes
Shorter-term Notes, defined as having a maturity of not more than 2 years, may also be issued to provide interim financing in anticipation of subsequent definite sources of revenues. Examples include Tax Anticipation Notes (hereinafter "TANs"), which are issued in anticipation of specific tax revenues, and Bond Anticipation Notes (hereinafter "BANs"), which will be repaid from the proceeds of a future bond issue.

> ***(For example, 3 series of 1-year Tax Anticipation Notes were issued in the late 1990's in order to provide continued funding for the EMS program when their property tax levy lapsed for one year. Similarly, several series of BANs have been issued over the past 5 years to provide interim financing for both several large facilities construction projects and for certain open space acquisitions, in anticipation of the eventual issuance of bonds that provide the permanent financing. 2007 Comment).***

4.3 Variable Rate Debt
The county may issue variable rate debt in order to lower the cost of borrowing and, in accordance with the principles of asset-liability management, to reduce the county's exposure to changes in interest rates.

There are several different forms of variable rate debt, the most common of which are variable rate demand bonds (VRDBs), auction rate notes (ARNs) and commercial paper (CP). The county will assess the comparative costs (both issuance and ongoing), trading differential, required administrative effort and the ability to achieve other financing goals when determining the appropriate vehicle to be used for its variable rate debt issues.

> ***(The variable rate debt currently issued on behalf of the Wastewater Enterprise Fund has taken the form of both VRDBs and CP. 2007 Comment)***

4.4 Payment Agreements
When appropriate, the County will utilize payment agreements to produce synthetic fixed rate or variable rate debt instruments in order to either take advantage of market opportunities to lower overall debt service costs or to manage exposure to changes in interest rates and other risks.

As defined under state law (RCW 39.96), a payment agreement is a written agreement which provides for an exchange of payments based on interest rates, or for ceilings or floors on these payments, or an option on these payments, or any combination thereof. A payment agreement can also be entered into on either a current or forward basis. A typical form of payment agreement is an "interest rate swap" in which one party exchanges a variable rate for a fixed rate with another party.

The use of payment agreements expose the county to one or more of a number of risks that are not present, or are present to a more limited degree, in relation to the issuance of standard county debt instruments. The risks include, but are not limited to, basis risk, tax risk, termination risk and counter-party risk. Due to these risks, the use of payment agreements will require the county to devote greater resources to their subsequent monitoring and administration.

In recognition of the added risk exposure, the use of a payment agreement will only be contemplated when it can be satisfactorily documented that the benefits compensate for the additional risks and administration costs by an appropriate margin.

The rationale for and the guidelines governing the execution and management of such payment agreements are presented in detail, together with definitions of certain terms and risks, in Appendix A--King County Payment Agreement Policy.

> ***(In recent years, it may have been advantageous for the County to borrow on a variable rate basis and then swap into a fixed rate. Such use of interest rate swaps would have resulted in lower borrowing costs for the County and thereby increased debt service savings when compared to the more traditional refunding***

transaction in which a fixed rate is replaced with a lower fixed rate. For example, a swap to a fixed rate of 4 percent could achieve greater debt service savings than a traditional refunding transaction that results in a fixed rate of say 4.25 percent. Note that other large issuers in Washington that have either adopted swap policies or are very close to doing so include the University of Washington, Sound Transit, Chelan County PUD, the City of Tacoma, and the Ports of both Tacoma and Seattle. 2007 Comment).

4.5 Conduit Financing Vehicles

Although they will typically entail somewhat higher financing costs compared to the issuance of standard county debt, for certain projects the county will rely on alternative conduit financing vehicles such as 63-20 Bonds or Certificates of Participation (COPs) that are issued by third parties but are still secured by county revenues such as property lease payments.

The rationale for the use of such conduit financing vehicles is that they may provide other benefits to the county that more than offset the higher financing costs. Such benefits stem from the fact that the use of such conduit financing vehicles allows projects designed for the county's use to be constructed and owned by private parties. The private parties agree to accept the risks associated with construction costs and can usually maintain the facility at a lower annual operating cost.

(63-20 bonds have been issued on the County's behalf to finance the construction of the King Street Center, the Pat Steel Building at Harborview, the Goat Hill New County Office Building and Parking Facility, and the NJB Project at Harborview, while COPs were issued for the Issaquah District Court House. 2007 Comment.)

5.0 Security for Debt Instruments

5.1 General Obligation (GO) Debt

The lowest cost of funds will normally be obtained through the issuance of general obligation debt secured by the full faith and credit of the county. General obligation debt can be either unlimited or limited:

- *Unlimited Tax General Obligation (UTGO) Debt* is payable from excess tax levies that are approved by the voters. Any proposition for UTGO debt must be approved by 60% of the voters casting a vote and the total number of ballots cast must be at least equal to 40% of the total number of voters voting in the last general election.
- *Limited Tax General Obligation (LTGO) Debt* is payable from regular current expense fund tax levies and revenues, and includes all types of obligations whether bonds, notes, lease-purchase financing contracts, loans or other payment obligations.

Although ultimately pledging current expense fund revenues, LTGO debt is also issued for the benefit of other county funds that can document sufficient future revenues to pay the debt service incurred. In cases in which the county pledges its full faith and credit in support of debt issued on behalf of other funds, the current expense fund may levy a charge on such funds as compensation for the provision of such credit enhancement. The criteria for such charges are determined by OMB in consultation with the Division.

> ***(For example, the Wastewater Treatment, Transit, Solid Waste, Surface Water Management and the Airport Enterprise Funds all presently pay an annual credit enhancement fee to the Current Expense Fund equal to 12.5 basis points of the outstanding LTGO bonds that have been issued on their behalf. 2007 Comment).***

Total GO debt -- limited and unlimited tax -- is subject to a statutory limitation of 5.0% of the County's assessed valuation. Of this amount 2.5% may be used for county purposes and 2.5% may be used for metropolitan functions (currently Wastewater Treatment and Transit). Within these limits, total LTGO debt is subject to a statutory limitation of 1.5% of the county's assessed valuation. Of this amount, LTGO debt issued on behalf of the county's metropolitan functions is further limited to 0.75% of the county's assessed valuation.

The county will attempt to maintain a substantial amount of unused debt capacity within these limitations in order to preserve future financing flexibility.

> ***(Currently, the county utilizes no more than 45% of any of the above limitations. The County's relatively limited reliance on debt has consistently been one factor that has contributed to its high credit ratings. 2007 Comment.***

5.2 Revenue-backed Obligations

When it is both feasible and cost-effective, the county will finance the capital assets by issuing debt secured solely by a pledge of certain revenues (including special dedicated taxes). These revenue-backed obligations may not impact the county's GO debt limits and therefore preserve the county's unused debt capacity.

In order to provide greater protection for the holders of revenue-backed obligations, the issuance of revenue-backed obligations will normally require the county to meet certain specific covenants. These covenants may include the establishment of a debt service reserve fund, additional reporting requirements, and the achievement of required debt service coverage ratios. Complying with such covenants may entail additional costs for the county.

While there may be no statutory limits to the amount of such revenue obligations that can be issued, there are limitations related to the county's ability to repay the debt. Prior to issuing new revenue-backed obligations, the county must satisfy an Additional Bonds Test. An Additional Bonds Test demonstrates that the current revenues pledged as security would be sufficient to meet required debt service coverage requirements on both

the new obligations and any existing obligations issued on parity with the new obligations in each year that the new obligations are outstanding.

> ***(The County has issued such revenue-backed obligations on behalf of both its Transit Enterprise Fund, pledging its sales tax revenues, and its Wastewater Enterprise Fund, pledging all sewer revenues. 2007 Comment)***

5.3 Double-barreled Obligations

One objective of the county's debt management practices is to preserve adequate capacity to finance future needs with GO debt by remaining well within the statutory limits. Preserving a large cushion of unused debt capacity allows the county to decide when it is economically advantageous to issue "double-barreled" bonds. These double-barreled bonds are so named because they are secured by both specific revenues and the full faith and credit of the county.

By issuing double-barreled bonds, the county's current expense fund is effectively providing credit enhancement to other county funds. Bonds secured by the full faith and credit of the county will typically be rated more highly by the credit rating agencies than revenue-backed obligations. As a result of the higher credit rating, the interest rates obtained on double-barreled LTGO bonds will normally be lower than interest rates for the comparable revenue-backed obligations.

Before issuing double-barreled LTGO bonds, the Division will take into account several factors including the estimated debt savings, the risk to the County's current expense fund, the county's remaining debt capacity and the anticipated impact on the county's overall credit rating. Specifically, the county will review whether the anticipated savings in debt service costs are sufficient to justify using the full faith and credit of the county to provide additional credit enhancement to revenue-backed obligations. To maximize the benefits obtained from utilizing the county's finite capacity to issue double-barreled LTGO bonds over time, the Division will not only consider the absolute benefits available in terms of lower interest rates but also whether prevailing credit spreads (i.e. the differentials in interest rates for differences in credit ratings) are narrow or wide by historical standards.

> ***(Double-barreled LTGO bonds have been periodically issued on behalf of both Transit and Wastewater since 1994. 2007 Comment.)***

5.4 Credit Enhancement

Credit enhancement instruments such as bond insurance or bank credit facilities will be used to provide additional security for county debt when it can be demonstrated that the cost of these instruments is expected to be more than offset by the resulting reduction in debt service.

6.0 Guiding Principles of Debt Management

6.1 Purpose

Although certain of the county's funds may have financial policies that dictate funding a portion of their capital assets out of their cash on hand, debt funding is the preferred option for financing the acquisition or construction of the County's capital assets. The county has set a minimum threshold that a capital asset must have an expected useful life of at least three years to be considered for debt financing.

Debt financing offers three benefits over cash financing of capital assets. First, the use of debt means that the county is not forced to postpone capital expenditures until it has accumulated sufficient funds. Second, the repayment of debt over an extended period allows the cost of such assets to be spread over future users of those assets, thereby providing greater inter-generational equity. Third, debt financing allows the county to maximize its benefit from the subsidy for municipal entities provided by the federal government through the ability to issue debt on a tax-exempt basis.

Shorter-term notes, defined as having a maturity of not more than 2 years, may also be issued to provide interim financing in anticipation of subsequent definite sources of revenues such as taxes or the issuance of long-term bonds. Although use of such notes may be justified for a number of different practical reasons, notes shall NOT be used to postpone the issuance of bonds purely in expectation of future declines in the county's long-term borrowing costs.

> ***(The county currently has two ongoing financing programs that are utilizing BANs, one to fund a variety of facilities projects and one to fund certain open space purchases. The justifications for using BANs to provide interim financing for each of these programs are different. The rationale for using BANs to fund facilities projects is to defer the payment of debt service by the Current Expense Fund until the time that the projects are completed and the county is enjoying beneficial use. In contrast, the rationale for using BANs for the open space purchases has been to comply with certain financial policies that limit the amount of conservation futures revenue (the source of repayment in this case) that can be used for debt service by postponing incurring new debt service payments until existing debt service payments drop off. 2007 Comment).***

Debt financing will not be used to finance current operations. However, for certain large non-recurring operating expenses (e.g., a lawsuit settlement) the county may determine that it is prudent to fund these expenditures through the issuance of debt in order to amortize the payment of such an expense over a period of several years. In addition, conditions may exist where the county would find it economically advantageous to pre-fund certain ongoing operating expenditures (e.g., pension of post-employment benefits payments) through the issuance of debt.

> ***(For example, the county issued bonds to finance the payouts required under the Logan-Knox Litigation Settlement in 1999. 2007 Comment..)***

6.2 Term of Financing

The term of any financing will not exceed the estimated useful life of the asset(s) being financed.

(For example, the bonds issued for the acquisition of open space or the construction of facilities will typically have maturities ranging somewhere between 15 and 40 years, whereas those for technology projects will typically have lives of between 3 and 10 years. 2007 Comment.)

The term of financing will also not exceed the term of any revenue streams that are specifically dedicated to the payment of the debt service on the financing.

(For example, although used to construct a facility with a potential useful life of 30+ years, the Safeco Field bonds issued had a final maturity of only 19 years because the taxes pledged to the repayment of the bonds expire at the end of 2016. 2007 Comment).

6.3 Debt Service Profiles

The county will generally structure its fixed rate bonds to produce approximately level annual debt service payments (comprised of both principal and interest) over the life of the debt.

An issue of GO bonds is often used to provide financing for a number of separate projects, each of which may have different useful lives. Such so-called "various-purpose" bond issues are essentially a composite of individual bonds for each of the separate projects. As such, although debt service will be usually be levelized on a project-by-project basis, the debt service profile for the bond issue in aggregate will normally exhibit a series of discrete declines after the principal for each of the projects is fully amortized.

(For example, a various-purpose bond might be issued to provide financing for both technology projects, which have a relatively short useful life of perhaps 5 years, and facilities projects or open space purchases that would be amortized over a useful life of perhaps 20 years. In such an example, the debt service profile on the entire bond issue would exhibit a decline after the fifth year when the portion used for the technology projects would be fully amortized. 2007 Comment).

Back-loading of principal, however, will be considered in certain circumstances. Such circumstances include when the benefits from the debt issuance can clearly be demonstrated to be greater further in the future; when such structuring is beneficial to the overall amortization schedule of a fund's capital structure; or when the structure will more closely match debt service to the anticipated repayment source.

(For example, the sewer revenue bonds have frequently been sold with no principal amortization beginning until 2015 in order to help smooth the overall

amortization scheduled of the wastewater enterprise. Similarly, the Safeco Field bonds were structured in such a way as to produce a 2% annual increase in the debt service in order to reflect the projected increase in the revenues generated by the taxes pledged for the repayment of these bonds. 2007 Comment).

6.4 Use of Inter-Fund Loans

Before issuing anticipation notes to provide short-term financing for a project, the issuance and interest costs shall be compared with the cost of meeting the cash-flow need through temporary borrowing via an inter-fund loan from the county's investment pool.

All inter-fund loan requests shall be submitted to the Division for review to ensure that suitable reimbursement language is included. Following Division review, the request will be submitted to the EFC for final review and approval.

(Although the costs of issuance associated with anticipation notes are relatively low, inter-fund loans will typically be more advantageous when the amount to be borrowed is relatively small and/or the anticipated term of the financing is short. 2007 Comment).

6.5 Refunding Transactions

The county will refinance outstanding debt as appropriate for the purpose of achieving debt service savings.

Municipal bonds are routinely issued with provisions that allow the bonds to be called (i.e. retired) after ten years. The right of municipal issuers to call their debt after ten years is an option that has economic value.

Under current U.S. Treasury regulations, the county is limited to refunding an issue only once prior to its call date. Given this limitation, refunding transactions should only be undertaken if they achieve certain threshold debt service savings targets. This will establish the minimum economic value that the county will accept for exercising a call option.

In most refunding transactions, the county simply issues new fixed rate bonds (the refunding bonds) with a life equal to the remaining life of the bonds to be refunded (the refunded bonds), the proceeds of which will be used to pay off the refunded bonds.

In such cases, unless otherwise justified, "advance refunding" transactions -- those undertaken more than 90 days prior to the first call date of the debt to be refunded -- will be completed only when the net present value of the debt service savings achieved as a result of the refunding is equal to at least 5% of the principal amount of the refunded bonds. (In most cases, such savings will be calculated on an aggregate rather than an incremental basis.)

Because the value of the call option declines as bonds approach their stated maturities, the target savings for "current refunding" transactions -- those undertaken either within 3-months of or after the first call date of the refunded debt -- shall take into account the remaining life of the refunded bonds. Unless otherwise justified, a current refunding will require graduated minimum net present value savings as follows:

Remaining years	Present Value Savings
<2	1%
>2 & <4	2%
>4 & <7	3%
>7 & <10	4%
>10	5%

(The refunding savings targets identified above are quite widely adhered to within the municipal finance industry. For example, these targets are the same as those identified by the Washington State Finance Committee in its Debt Policy. 2007 Comment)

Instead of issuing fixed rate refunding bonds, on occasion the county may issue variable rate bonds and then enter into an interest rate swap agreement to produce a fixed rate refunding bond issue. In recognition of the additional risks associated with such swap-based transactions, however, the county must achieve minimum present value debt service savings threshold targets that are *2%* higher than those identified above and are also at least *2%* higher than those that would be produced from a comparable traditional refunding.

Unless otherwise justified, the maturity of any refunding bonds will not extend beyond the remaining life of the original bonds and the transactions will typically be structured in such a way as to produce approximately equal debt service savings in each of the remaining years of the life of the original bonds.

(Almost all of the county's recent refundings have indeed been structured to produce level debt service savings. However, the two refundings of the baseball bonds have been used as opportunities to adjust the debt service to match revised revenue projections and to shorten the remaining lives of the bonds. 2007 Comment).

A refunding that does not meet the present value savings targets identified above may still be undertaken if there are other resulting considerations such as the desire to eliminate burdensome covenant restrictions or to respond to other possible changes that affect the county's debt.

The county will not refund debt for the sole purpose of deferring debt service unless justified by unique circumstances.

6.6 Tax-exempt vs. Taxable Debt

The county will endeavor to issue tax-exempt debt whenever possible under the IRS tax code.

For certain projects that include usage by private or non-profit entities beyond allowable limits, however, it will on occasion be necessary for the county to issue taxable debt. The county will minimize taxable debt by using cash to the greatest extent possible for project components that are ineligible for tax-exempt financing.

In certain other circumstances, it may also be prudent for the county to issue taxable debt in order to avoid the sometimes burdensome restrictions involved in complying with IRS regulations. The county shall weigh the costs of complying with such regulations against the benefits of lower-cost financing from issuing the debt on a tax-exempt basis.

> ***(For example, the bonds that were issued for the parking facilities at Safeco Field were required to be sold on a taxable basis. 2007 Comment).***

6.7 Fixed vs. Variable Debt

The majority of county debt takes the form of fixed rate long-term debt. Such debt provides the benefit of providing stable and certain annual debt service payments. While fixed rate bonds offer long-term predictability for debt service costs, it is prudent for county funds of sufficient size to finance a portion of their capital program using variable rate debt for the following reasons.

- *Reduced exposure to changes in interest rates.* An important advantage of using variable rate debt is that it would act as a natural "hedge" to the exposure of the different county funds to the impact of changes in short-term interest rates on their investment income. Most county funds have significant cash balances that are held in the county's investment pool. Since the Investment Pool is typically invested in relatively short-term instruments, changes in interest rates will result in volatility in the total revenues of county funds. Because changes in the interest rates on variable rate debt are likely to be positively correlated with changes in the yield on the county investment pool, changes in the interest expense of variable rate debt will provide a natural offset to changes in the investment income as interest rates increase or decrease. Using variable rate debt to fund a portion of their capital structure would therefore reduce the exposure of county funds to changes in interest rates.

  Furthermore, the amount or percentage of variable rate debt to be incurred in order to hedge against volatility in a fund's interest earnings on its investment balances does not require an exact matching of cash assets with variable debt liabilities. The reason for this is that changes in taxable interest rates, which are earned by the Investment Pool, are expected to result in smaller absolute changes in tax-exempt interest rates, which the county pays on its variable rate debt. (Note: Variable rate debt issued solely to act as a hedge against invested assets

will henceforward be termed "hedged variable rate debt", while any additional amounts will be termed "unhedged variable rate debt").

- *Increased financing flexibility.* A second advantage of issuing variable rate debt instruments is that it provides greater financing flexibility. While fixed rate debt is almost always sold with a ten-year call feature, variable rate debt can usually be redeemed at any time. This flexibility can be useful in restructuring the county's debt service pattern or if there is uncertainty regarding the timing of the revenues to be used to retire principal. Certain types of variable rate debt also incorporate an option for the county to convert the debt to fixed rate bonds. As opposed to relying on the potentially time-intensive process of issuing new bonds, the ability to exercise this option provides the county with greater flexibility to respond quickly to changes in financial market conditions if it is considered prudent to lock in long-term fixed rates.
- *Lower debt service costs.* The third important advantage of issuing variable rate debt is that such debt is likely to produce lower debt service costs over time. This expectation is based on the historical experience that the normal shape of the yield curve is upward-sloping, meaning that short-term interest rates at any point in time are likely to be lower than long-term interest rates, together with the evidence that forecasts of interest rates implied by the yield curve systematically tend to overstate future rates because investors value the liquidity of short-term debt instruments. In combination, these considerations mean that variable rate debt, the rates on which reflect short-term yields, should result in a lower cost of borrowing over time than using fixed rate long-term bonds.

  (The county has so far only issued variable rate debt on behalf of the Wastewater Enterprise Fund. To date, such borrowing has resulted in significantly lower debt service costs. For example, while this has admittedly been a period that has for the most part been characterized by unusually low short-term interest rates, the Wastewater Fund has saved in excess of $16 million in debt service costs over the past five years by issuing $100 million in variable rate debt in mid-2001 as opposed to issuing additional fixed rate debt. 2007 Comment).

  (It should be noted that the yield curve in the municipal bond market has never actually inverted as has been seen on many occasions in the Treasury bond market. 2007 Comment).

The potential risk associated with issuing unhedged variable rate debt to take advantage of such lower expected lifetime borrowing costs is that increases in interest rates may cause significantly higher debt service costs that may be difficult for different county funds to absorb out of their available revenues. The prudent level of outstanding unhedged variable rate debt for each of the different county funds will therefore depend on several considerations such as the stability and/or controllability of their revenues. The county will solicit input from its financial advisor and/or from the credit rating agencies regarding the appropriate amount of both hedged and unhedged variable rate debt for each different fund.

(The Wastewater Enterprise Fund's financial policies currently limit total hedged and unhedged variable debt to 15% of their fixed-rate bonds. It would probably be advantageous for most other county funds to have some portion of their capital program comprised of both hedged and unhedged variable rate debt. 2007 Comment).

7.0 Debt Issuance Methods

7.1 Reliance on Professional Advisors

In selling debt, the county will place heavy reliance on its financial advisor(s) and bond counsel(s), and, in the case of negotiated sales, the underwriter(s). Following are definitions of these roles and responsibilities:

- *Financial Advisor:* The primary role of the county's financial advisor is to identify the market opportunities for bond sales and ensure the county's financial interests are protected on any debt issuance. The financial advisor helps determine the structure and timing of the bond issue, evaluates bond sales, and assists in the closing of transactions.
- *Bond Counsel:* The primary role of bond counsel is to certify that the county has legal authority to issue the bonds. The bond counsel also works with the county to ensure compliance with all statutory and procedural requirements.
- *Underwriter:* The primary function of the underwriter is to purchase debt issues from the County and resell them to investors. In a negotiated sale, the underwriter provides expertise regarding the structure of the debt issue that will enhance its marketability.

Consistent with county procurement practices, the Division will periodically issue Requests for Qualifications (RFQs) in order to enter multi-year contracts (or other arrangements) with such professionals. The preferred candidates will be selected on the basis of their experience, the proposed pricing of their services, and other considerations deemed appropriate.

7.2 Competitive Sales

The county prefers to sell debt by means of competitive sales.

In a competitive sale, the county solicits bids from underwriting firms to purchase its debt, and sells the debt to the firm offering the lowest interest cost bid. The county prefers this method because: (1) it ensures that the debt is sold at the lowest interest cost given market conditions; (2) the underwriting cost tends to be lower compared to negotiated sales; and (3) it promotes the appearance of an open and fair process.

7.3 Negotiated Sales

Negotiated sales will be used, however, for certain debt issues for which a specific result is required and for more complicated debt issues for which closer underwriter input can provide added value in the structuring and marketing of the debt.

(For example, most of the refunding bonds issued over the past 5 years have been sold on a negotiated basis. The reason is that this method of sale provides considerable flexibility to respond to changes in market conditions on the day of the sale, which in turn may impact the size of the refunding transaction that can be undertaken in order to achieve the county's present value savings target (see "Refunding Transactions" above). Negotiated sales have also been used for more complex transactions such as the Safeco Field bonds and the recent conduit financings. 2007 Comment).

7.4 Private Placements

In certain unique circumstances, the county may also utilize private placements.

(The only example of a private placement over the past decade was the sale of the 1997A bonds to Bank of America, the proceeds of which were used to provide for the cost of issuance for the Safeco Field bonds. A public sale of this portion of the bonds was not considered feasible because of the significant legal risks surrounding the project which, had they not been resolved in the county's favor, could have forced the county to immediately retire the bonds. 2007 Comment)

7.5 Credit Enhancements

As mentioned earlier, credit enhancement instruments such as bond insurance or bank credit facilities will be used to provide additional security for county debt when it can be demonstrated that the cost thereof is expected to be more than offset by the reduction in debt service. (Note: When sold competitively, the decision to insure bonds is made by the winning underwriter rather than by the county.)

8.0 Debt Administration Duties

8.1 Investment of Proceeds

Each bond ordinance will provide for the establishment of funds and accounts, which will be designated in advance by the county. Each ordinance will identify the investing officer for the funds held by the county, and any investments will generally be made in accordance with the county's Investment Policy and procedures established by the county. The county will consider investment agreements on a case-by-case basis, and enter into agreements when appropriate through a process of competitive bidding that adheres to U.S. Treasury regulations and guidelines.

8.2 Arbitrage

Prior to any debt issuance, the Division shall be provided with information regarding the expected timing and amount of expenditures to be made from the project fund. The Division will provide this information to Bond Counsel for use in developing the Arbitrage Certificate.

The Financial Management Section within the Division will keep records of expenditure of bond proceeds and bond funds sufficient for the Treasury Operations Section within

the Division to develop calculations required for compliance with arbitrage and other tax law requirements.

The Treasury Operations Section is not responsible for arbitrage and other tax law requirements for junior taxing districts for which the county serves *as ex officio* treasurer. No such district is authorized to obligate the county in any way relating to these documents.

8.3 Financial Disclosure
The county is committed to providing full financial disclosure.

The Division will serve as the focal point for information requests relating to official statements to be used in the initial offering of the county's bonds or notes. The Division will request from relevant departments and offices, information required for disclosure to investors and rating agencies. Each department or office bears responsibility for the information provided for use in the county's official statements.

The Division will ensure that the county complies with applicable securities law in providing full disclosure upon the issuance of all debt and meets its continuing disclosure undertakings in a timely manner.