## STAFF REPORT

|  |  |  |  |
| --- | --- | --- | --- |
| **Agenda Item:** | 5 | **Name:** | Nick Bowman |
| **Proposed No.:** | 2021-0333 | **Date:** | November 16, 2021 |

**SUBJECT**

A MOTION adopting an updated Debt Management Policy for King County.

**SUMMARY**

The Proposed Motion would adopt an updated County Debt Management Policy and rescind the previous Debt Management Policy adopted by the Council in 2007 under Motion 12660. The policy provides guidance for the County’s issuance and subsequent post-issuance administration of its municipal debt portfolio. According to the Executive, several significant developments in municipal finance are not adequately addressed in the current County Debt Management Policy. Therefore, County Finance and Business Operations Division (FBOD) staff, in consultation with the County’s external financial advisor, have proposed an updated policy document that more appropriately reflects current best practices.

Adoption of a written debt policy is both required by State Law[[1]](#footnote-1) and, according to the Executive, has been identified by credit rating agencies as a source of rating strength.

The proposed update to the County Debt Management Policy was transmitted concurrently with proposed legislation that would update the County’s Comprehensive Financial Management Policies.[[2]](#footnote-2)

**BACKGROUND**

In 2007, the Council adopted a formal debt management policy that was consistent with existing County debt management practices.[[3]](#footnote-3) The policy document provided a written account of the County's debt management goals and objectives, described the debt instruments used by the County and the parameters for their use, outlined the debt issuance process including the roles and responsibilities of the involved parties, and stated the County's debt management principles.

The adopted debt management principles are as follows:

1. Debt financing is the preferred option for the acquisition or construction of capital assets.
2. Debt financing will not be used to finance current operations.
3. Financing terms will not exceed the estimated useful life of the financed asset.
4. Bonds will be structured to produce level annual debt service payments.
5. Debt refinancing will be pursued for the purpose of achieving debt service savings.
6. Tax-exempt debt will be issued whenever possible.

The 2007 Debt Management Policy also authorized the use of payment agreements. A payment agreement is a written agreement which provides for an exchange of payments based on interest rates with the primary objective of lowering borrowing costs.

A typical form of payment agreement is an "interest rate swap," which is a contract entered into by an issuer with a swap provider to exchange periodic interest payments. Normally, one party agrees to make payments to the other based upon a fixed rate of interest in exchange for payments based on a variable rate. For example, the County may issue variable rate debt and simultaneously enter into a payment agreement. In doing so, the County would agree to pay a fixed rate of interest in exchange for receiving payments based on its variable rate (a variable-to-fixed interest rate swap) that are expected to be similar to the amount payable on the variable rate debt that it issued. The resulting fixed “swap” rate paid by the County would typically be lower than if the County had issued fixed-rate debt directly; thereby achieving debt service savings.

Motion 12660 further tasked the Executive Finance Committee (EFC)[[4]](#footnote-4) with periodically reviewing the County's Debt Management Policy and considering amendments as appropriate. Any proposed amendments would be submitted to the Executive and the Council for final approval.

**ANALYSIS**

Proposed Motion 2021-0333 would rescind the County's current Debt Management Policy and replace it with an updated Debt Management Policy drafted by Finance and Business Division (FBOD) staff, in consultation with the County's external financial advisor, and recommended by the EFC. According to the Executive, the update is necessary to reflect significant changes that have occurred in municipal finance since the adoption of the original policy in 2007.

As with the initial Debt Management Policy, the updated policy document provides a written account of the County's debt management goals and objectives, describes the debt instruments used by the County and the parameters for their use, outlines the debt issuance process including the roles and responsibilities of the involved parties, and states the County's debt management principles. While broadly similar, the proposed policy makes a number of changes and additions to the 2007 policy which range from the technical and stylistic to the substantive.

**Technical and Style Updates.** The proposed policy update includes various technical revisions which do not functionally alter existing policy. These revisions include changing the language describing certain debt instrument types to be more consistent with contemporary definitions, updating the names of County departments/agencies to reflect their current designation and rewriting certain sections for clarity.

The proposed policy update also includes changes which are more style oriented. For instance, a multitude of "County-specific" examples (examples describing how the County utilizes different types of debt instruments or explaining the application of specific County practices) included throughout the 2007 policy document, are proposed to be removed. While the debt management policy provides internal guidance for the County's issuance and administration of its debt, the policy is also shared with a wider external audience (i.e., rating agencies, potential investors, etc.). According to the Executive, removing the "County-specific" examples was intended to portray a more professional appearance to that external audience.

**Substantive Policy Updates.** The proposed policy update includes substantive language changes, deletions and additions which are summarized by section below. It should be noted, that while the proposed changes are new to the policy document, Executive staff stated that all changes reflect current practices the County is already adhering to.

*Section 5: Security for Debt Instruments & Liquidity Support*. New language is added regarding "liquidity support," which states that the County will consider the use of its own assets as an alternative source of liquidity support for certain forms of variable rate debt, to avoid fees for bank-provided facilities and to eliminate certain risks.

*Section 6: Guiding Principles of Debt Management*. A statement explicitly stating that debt funding is the preferred option for financing the acquisition or construction of the County's capital assets is deleted and replaced with a statement declaring that "debt financing is primarily utilized to provide funding for the acquisition and construction of County capital assets."

Adds a new subsection 6.2 "Issue Size." The new subsection states that, to take advantage of economies of scale in issuance costs, the County, when feasible, will attempt to combine the financing of several different projects into larger debt issues.

Adds new language to subsection 6.7 "Refunding Transactions." The new language describes the options which the County may have available, depending on the IRS regulations, to refund outstanding bonds earlier than the typical 90 days prior to their call date and the parameters in which the County would utilize such options. The updated policy also increases the minimum present value debt service savings threshold targets for entering swap-based refunding transactions from 2% to 5%.

Adds a new subsection 6.9 "Limited Renewal, Market Access and Rollover Risk." The new subsection describes the risks associated with variable rate debt and the steps the County will take to limit its exposure to those risks. Limited Renewal risk stems from potential constraints on opportunities to renew bank credit or liquidity facilities that secure variable rate debt obligations, should a particular bank or the entire banking sector experience an environment of economic turmoil, limiting the County’s renewal options to unattractive terms, if renewal is available at all. Market Access and Rollover Risks are similar to that of Limited Renewal risk, but with relation to Bond Anticipation Notes used to provide interim project financing. To limit these risks, the County will employ strategies such as diversifying the banks it enters arrangements with, staggering the dates of expiration of such arrangements and maintaining excellent credit ratings.

Adds a new subsection 6.10 "Limited Market Timing." The new subsection states that the County will not attempt to structure and time debt issuances based on interest rate forecasts. Furthermore, unless specific debt service or rate targets need to be met, the County will issue debt as expeditiously as possible to support the financing schedules of its capital projects and to take advantage of refunding opportunities.

*Section 7: Debt Issuance Methods*. New language is added indicating the County’s intent to place reliance on disclosure counsel for selling debt and describes the primary role of disclosure counsel, which is to help ensure, then certify, that the County's offering documents provide all necessary and relevant information to potential investors.

*Section 8: Debt Administration Duties*. New language is added stating that the proceeds from refunding transactions will be invested in highly rated securities including those issued by the United States Treasury and other securities permitted under State Law.

Deletes subsection 8.2 "Arbitrage" and replaces it with a new subsection 8.2 "Post-Issuance Tax Compliance." The new subsection states that the County will adhere to written procedures for post-bond issuance tax compliance with federal tax law. The new subsection retains language from the deleted "Arbitrage" subsection, which states that the FBOD is not responsible for arbitrage and other tax law requirements for junior taxing districts for which the County serves as *ex officio*  treasurer.

New language is added to subsection 8.3 "Financial Disclosure." The new language assigns FBOD the responsibility of managing the adherence to written disclosure procedures adopted by the EFC, for compiling information provided by County agencies needed for official statements used in initial debt offerings and for responding to requests from bondholders, rating agencies, and other parties facilitated through a publicly accessible investor webpage.[[5]](#footnote-5)

Appendix A King County Payment Agreement Policy. Adds a new section 13.0 "Qualified Independent Representative. The new section requires the County to select and retain a "Swap Advisor" to provide guidance with respect to swap transactions and to act as the Qualified Independent Representative (QIR) as required by the U.S. Commodities Futures Trading Commission promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new section also details the Swap Advisor selection criteria, requires the County to preform annual performance reviews, and requires the Swap Advisor to provide the County with evaluations of all proposed swap transactions including modifications, cancellations, and options.

**Concurrent Transmittal with Comprehensive Financial Management Policy Update.** The updated County Debt Management Policy was transmitted by the Executive concurrently witha proposed motion which would adopt revised County comprehensive financial policies. The financial policy document includes references to the County's Equity and Social Justice (ESJ) Ordinance, including that the "budget and its processes will adhere to [the ESJ Ordinance's] guiding principles," and that the County ESJ Ordinance will, in conjunction with other policies, guide County decisions regarding revenue generation and expenditures. The updated County Debt Management Policy does not include any references to the County's ESJ Ordinance or its guiding principles. According to the Executive, the nexus between the County’s ESJ principles and the principles of debt management were deemed tangential and therefore were not referenced.

**INVITED**

* Ken Guy, Director, Finance and Business Operations Division
* Nigel Lewis, Senior Debt Analyst, Finance and Business Operations Division

**ATTACHMENTS**

1. Proposed Motion 2021-0333 (and its attachment)
2. Transmittal Letter
1. RCW 36.48.07 [↑](#footnote-ref-1)
2. Proposed Motion 2021-0334. This item is scheduled to be taken up by the Budget and Fiscal Management Committee in early 2022. [↑](#footnote-ref-2)
3. Motion 12660 [↑](#footnote-ref-3)
4. The Executive Finance Committee, which per KCC 4.10.050 consists of the county executive; the manager of the finance and business operations division; the director of the office of performance, strategy, and budget; and the chair of the county council, establishes County investment policies and oversees the investment portfolio to ensure that specific investments comply with both those investment policies and State law. [↑](#footnote-ref-4)
5. [www.kingcountybonds.com](https://gcc02.safelinks.protection.outlook.com/?url=http%3A%2F%2Fwww.kingcountybonds.com%2F&data=04%7C01%7CNick.Bowman%40kingcounty.gov%7C3206106091194eb1395a08d98dabf6b1%7Cbae5059a76f049d7999672dfe95d69c7%7C0%7C0%7C637696591976825357%7CUnknown%7CTWFpbGZsb3d8eyJWIjoiMC4wLjAwMDAiLCJQIjoiV2luMzIiLCJBTiI6Ik1haWwiLCJXVCI6Mn0%3D%7C1000&sdata=DbS24hutMVDfKNvzZc5cjDdwo4ZHEqR2vQhsOn7J4TY%3D&reserved=0) [↑](#footnote-ref-5)