

CITY OF LEXINGTON, TENNESSEE

DEBT MANAGEMENT POLICY

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Introduction

Debt Management Policies are written guidelines and restrictions that affect the amount and type of debt issued by a state or local government, the issuance process, and the management of a debt portfolio. A debt management policy improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates a commitment to long-term financial planning, including a multi-year capital plan. Adherence to a debt management policy signals to rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner.

Debt levels and their related annual costs are important long-term obligations that must be managed within available resources. An effective debt management policy provides guidelines for a government to manage its debt program in line with those resources.

Since the guidelines contained in the Policy require regular updating in order to maintain relevance and to respond to the changes inherent in the capital markets, the City plans to revisit the Policy from time to time. (See paragraph 16)

1. Policy Statement

In managing its debt, it is the City's policy to:

- Achieve the lowest costs of capital
- Ensure high credit quality
- Assure access to the capital credit markets
- Preserve financial flexibility
- Manage interest rate risk exposure

2. Goals and Objectives

Debt policies and procedures are tools that ensure that financial resources are adequate to meet the City's long-term planning objectives. In addition, the Debt Management Policy ("Policy") helps to ensure that financings undertaken by the City satisfy certain clear objective standards which allow the City to protect its financial resources in order to meet its long-term capital needs. The adoption of clear and comprehensive financial policies enhances the internal financial management of the City.

The Policy formally establishes parameters for issuing debt and managing a debt portfolio which considers the City's specific capital improvement needs; ability to repay financial obligations; the existing legal, economic, financial and debt market conditions. Specifically, the policies outlined in this document are intended to assist in the following:

- Guide City officials in policy and debt issuance decisions.
- Maintain appropriate capital assets for present and future needs.
- Promote sound financial management.
- Protect the City's credit rating.
- Ensure the legal use of the City's debt issuance authority.
- Promote cooperation and coordination with other service providers in the financing and delivery of services.
- To evaluate debt issuance options.

3. Municipal Advisor Appointment

In order to provide continuity in the management, issuance and delivery of services related to debt management, the City may appoint a Municipal Advisor which shall be appointed on the basis of recognized competence and integrity according to Tennessee Code Annotated § 12-4-106. The Municipal Advisor shall adhere to Policy guidelines. See paragraph 14.

4. Issuance Process & Costs

State law authorizes Cities to issue general obligation bonds subject to the adoption of a bond resolution by the Board of Mayor and Aldermen. Other sections of Tennessee Code Annotated and the Federal Tax Code may govern the issuance or structure of any debt issued. These provisions serve as the basis for the City's affordability guidelines described later in this Policy. Prior to the issuance of any debt a CT-0253 form will be presented as an estimate to costs associated with the transaction.

5. Credit Quality and Credit Enhancement

The City's debt management activities will be conducted in order to receive the highest credit rating(s) possible, consistent with the City's financing objectives. The City Mayor and City Recorder will be responsible for maintaining relationships and communicating with the rating agencies that assign ratings to the City's debt. The City shall prepare

presentations to the rating agencies to assist credit analysts in making an informed decision.

The City Mayor and/or City Recorder and/or Municipal Advisor will provide a credit presentation to the Board of Mayor and Aldermen, explaining any current or recent rating applied for, rating agency views on the City's performance and current items which may adversely or positively affect the City's credit rating.

The City will consider the use of credit enhancement on a case by case basis, evaluating the economic benefit versus cost for each case. Nothing shall prevent the City, to apply for Bond Insurance for any issue.

The City may purchase bond insurance when such purchase will result in a lower true interest costs taking into account the bond insurance premium for negotiated sales. For competitive sales, the City Mayor or City Recorder shall determine if Bond Insurance will be applied for, and if available, the purchaser of the bonds will determine whether bond insurance will be used.

The City will solicit quotes for bond insurance from interested providers, or in the case of a competitive sale will either apply for bond insurance, or allow bidders to request insurance. In a negotiated sale the City will select a provider whose bid is cost-effective and whose terms and conditions governing the guarantee are satisfactory to the City. The winning bidder in a competitive sale will determine the provider of bond insurance.

6. Debt Affordability

The ratios and standards identified in Exhibit A are intended to provide guidelines which permit and facilitate long-term access to capital while ensuring that financial leveraging decisions do not negatively impact the City's financial operations. The City shall consider the ability to repay debt as it relates to net debt per capita, net debt to assessed value, and ratio of debt expenditures as a percentage of total expenditures.

7. Bond Structure

The City shall establish all terms and conditions relating to the issuance of bonds, notes and other obligations and will invest proceeds pursuant to the terms of the resolution authorizing the issuance of the debt in compliance with applicable State law and to the extent the issue is tax-exempt with Federal tax laws and regulations governing their issuance. Unless otherwise authorized by the City, the following shall serve as the Policy for determining structure:

- (a) Term - All capital improvements financed through the issuance of debt will be financed for a period not to exceed the useful life of the improvements, and in consideration of the ability of the City to absorb the additional debt service expense within the debt affordability guidelines, but in no event will the term exceed forty (40) years or the amount allowed by State law.
- (b) Capitalized Interest - From time to time certain financings may require the use of capitalized interest from the issuance date until the City has beneficial use and/or occupancy of the financed project. Interest may be capitalized through a period permitted by Federal law and State statute if it is determined that doing so is beneficial by City officials

- (c) Debt Service Structure – General Obligation Debt issuance shall be planned to achieve relatively net level debt service amortization taking into consideration the City’s outstanding debt obligations, while matching debt to the useful life of the project being financed. The City shall avoid the use of bullet or balloon maturities, absent sinking fund requirements, except in those instances where these maturities serve to make existing overall debt service level or to match a specific income stream.

Revenue supported debt will be structured to achieve adequate debt service coverage ratios.

- (d) Call provisions - Typically, securities will include a call feature no later than ten (10) years from the date of delivery of the bonds. Non-callable bonds will be given careful evaluation by the City with respect to the value of the call option.
- (e) Original Issue Discount/Premium - Bonds with original issue discount/premium will be permitted.
- (f) Structured Products – The City chooses not to use derivative or other exotic financial structures in the management of the City’s debt portfolio. Any reversal of this provision and determination of the City to consider the use of structured products as a hedge against interest rate risk or a method to lower its costs of borrowing will be recommended by the City Mayor and/or City Recorder and approved by the Board of Aldermen. The City will comply with state guidelines and will be able to quantify and understand the potential risks or to achieve fixed and/or variable rate exposure targets. The City will not use structured products for speculative purposes (see paragraph 10).

8. Types of Debt

When the City determines that the use of debt is appropriate, the following criteria will be utilized to evaluate the type of debt to be issued.

- (a) General Obligation Bonds - Are supported by the full faith and credit of the City and are typically used to finance capital projects not supported with public utility type revenues. The City may also use its general obligation pledge to support other revenue supported bond issues, if such bond support improves the economics of the other bond issue and is used in accordance with these guidelines and State and Federal law.
- (b) Revenue Bonds - Are supported only with revenues generated from specifically designated sources. Revenue Bonds will be issued for capital projects which can be supported from project or enterprise fund related revenues.

9. Duration

Long-Term Debt (maturing after 3 years) - Long-term debt shall not be used to finance current operations. The City may issue long-term debt where it is deemed that capital improvements should not be financed from current revenues or short-term borrowings. Long-term debt will be structured in such a way that financial obligations do not exceed the expected economic life of the project(s) not to exceed 30 years except with respect to federally sponsored loans, provided such an exception is consistent with law and accepted practices.

- (a) BONDS/LOANS will be only be issued in fixed rate mode for projects with an economic life in excess of three years or greater
- (b) NOTES may be issued to for projects with an economic life of three to twelve years

Short-Term Debt (maturing within three years) - Short-Term borrowing may be utilized for the construction period of a long-term project or for the temporary funding of operational cash flow deficits or anticipated revenues (defined as an assured source with the anticipated amount based on conservative estimates) subject to the following policies:

- (a) Bond Anticipation Notes (BANS) may be issued instead of capitalizing interest to reduce the debt service during the construction period of a project or facility. BAN's shall be issued according to state and federal law and shall not mature more than two years from the date of issuance.
- (b) Revenue Anticipation Notes (RAN'S) & Tax Anticipation Notes (TAN'S) shall be issued only to meet cash flow needs consistent with a finding that the sizing of the issue fully conforms to Federal IRS regulations as well as state requirements and limitations.
- (c) Capital Outlay Notes shall be considered to finance projects with a useful life of twelve years or less.
- (d) Intrafund Loans shall only be used to fund operational deficiencies among accounts or for capital projects to be paid from fiscal year revenues. Such intrafund loans shall in no event extend beyond (60) months and shall only be issued in compliance with state regulations and limitations.
- (e) Other Short-term Debt may be used when it provides an interest rate advantage or as interim financing until market conditions are more favorable to issue debt in a fixed rate mode. The City will determine and utilize the least costly method for short-term borrowing. The City may issue short-term debt when there is a defined repayment source or amortization of principal.

10. Interest Rate Modes

- (a) Fixed Rate Debt - The City will issue fixed rate debt to maintain a predicable debt service burden.
- (b) Variable Rate Debt – Recognizing the benefits of variable rate debt for the financing of needed utility divisions infrastructure and capital improvements the City may issue variable rate debt as determined by the Board of Mayor and Aldermen. However, the City also recognizes the associated risks and will implement steps to mitigate these risks including:
 - The City will consider market fluctuations affecting the rate of interest in its annual budgeting for interest expense on outstanding variable debt.
 - Prior to entering into any variable debt obligation, the Board of Mayor and Aldermen will be informed of any terms, conditions, fees, or other costs associated with the prepayment of associated variable debt.

11. Refinancing Outstanding Debt

The City Mayor and/or City Recorder shall have the responsibility to analyze outstanding debt for refunding opportunities, in consideration of the following:

- (a) Debt Service Savings – Absent other compelling considerations such as the opportunity to eliminate restrictive covenants contained in existing debt documents, the City establishes a minimum present value savings threshold of 2.75% of advanced refunded bond principal, net of all costs of issuance. The decision to take savings on an upfront or deferred basis must be explicitly approved by the Board of Mayor and Aldermen. Current refunding opportunities will be considered if the refunding generates positive present value savings.
- (b) Restructuring for Economic Purposes – The City will refund debt when it is in the best financial interest of the City to do so. Such refunding will be limited to restructuring to meet unanticipated revenue expectations, achieve costs savings, mitigate irregular debt service payments, release reserve funds or remove unduly restrictive bond covenants or to mitigate the risks associated with any variable rate debt exposure issued prior to the adoption of this Policy.
- (c) Term of Refunding Issues – Bonds will be refunded within the original term. However, the City Mayor and/or City Recorder may recommend, subject to Board of Mayor and Aldermen approval, a maturity extension in order to achieve a desired outcome, provided the extension is legally permissible. The City Mayor and/or City Recorder may also consider shortening the term of the original issue in order to realize greater savings. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.
- (d) Escrow Structuring – The City shall utilize State and Local Government Securities (SLGS) to fund escrow accounts for an advanced refunding issue, if available. In the case of open-market securities, a certificate will be provided by a third party agent, who is not a broker-dealer stating that the securities were procured through an arms length competitive bid process, and that the price paid was reasonable within Federal regulations. Under no circumstance shall an underwriter, agent, financial advisor or municipal advisor sell escrow securities to the City from its own account.
- (e) Arbitrage – The City shall take all necessary steps to optimize escrows.

12. Methods of Issuance - The City in consultation with the Municipal Advisor will determine the method of issuance on a case by case basis and in accordance with State law.

- (a) Competitive Sale – In a competitive sale the issue shall be awarded to the bidder providing the lowest true interest costs as long as the bid adheres to the requirements set forth in the detailed notice of sale.
- (b) Negotiated Sale - The City recognizes that some issues are best sold through negotiation when permitted under State law. In its consideration of a negotiated sale, the City shall assess the following circumstances:
 - Timing the sale.
 - A structure which may require a strong pre-marketing effort for a complex transaction.
 - Size of the issue which may limit potential bidders.

- Market volatility is such that the City would be better served by flexibility in timing a sale.
- If the issue is a variable rate demand obligation (if allowed).
- Whether an idea or financing structure is a proprietary product of a single firm.

(c) Private Placement – From time to time the City may elect to privately place its debt. Such placement shall only be considered if this method is demonstrated to result in a costs savings to the City relative to other methods of debt issuance.

(d) Loans – From time to time the City may elect to enter into a loan pursuant to applicable state statutes, as may be determined by the Board of Mayor and Aldermen.

13. Underwriter Selection (Negotiated Sale)

The City Mayor or City Recorder, in consultation with the Municipal Advisor, shall evaluate each refunding opportunity and select an underwriter/lender which will meet the objectives in the plan of refunding. The City Recorder shall provide a report to the Board of Mayor and Aldermen after each sale.

The City Mayor and/or City Recorder in consultation with the Municipal Advisor, shall select a senior manager for a proposed negotiated sale. The selection criteria shall include but not be limited to the following:

- Ability and experience of the firm in managing similar transactions.
- Prior knowledge and experience with the City.
- The firms willingness to risk capital and demonstration of such risk
- Quality and experience of personnel assigned to the City's engagement.
- Financing ideas presented.
- Underwriting fees.

The underwriter must clearly identify itself to the City in writing (e.g., in a response to a request for proposals or in promotional materials provided to the City) as an underwriter and not as a financial or municipal advisor from the earliest stages of its relationship with the City with respect to that issue. The underwriter must clarify its primary role as a purchaser of securities in an arm's-length commercial transaction and that it has financial and other interests that differ from those of the City. The underwriter in a publicly offered, negotiated sale shall be required to provide pricing information both as to interest rates and to takedown per maturity to the City Recorder in advance of the pricing of the debt.

14. Municipal Advisor

In lieu of the City Mayor and/or City Recorder being primarily responsible for debt management and issuance, the City may select a Municipal Advisor (Advisor) to assist in its debt issuance and debt administration processes. Selection of the Advisor shall be based on, but not limited to, the following criteria:

- Experience with municipal government issuers and the public sector
- The firm's background in providing services, balancing of the City's needs for continuity, and innovation in capital planning and debt financing.
- Prior experience and success of the firm

- Independence from underwriting, trading, or activities that relate to conflicts of interest
- Qualifications and experience of the principal employee who will work with the City
- Consideration will be given to the proposed fee structure and to estimated costs, but price will not be a significant and sole determining factor.
- Proper registration with the Securities and Exchange Commission and the Municipal Securities Rulemaking Board.

Municipal Advisory Services - Municipal Advisory Services provided to the City shall include, but shall not be limited to the following:

- Advise on financial matters relating to proposed capital financing projects.
- Analyze the current debt profile and recommend appropriate changes to accomplish the City's objectives.
- Work with City officials in preparing resolutions, engaging bond counsel, drafting a Preliminary Official Statement, Official Statement, Notice of Sales and other related documents.
- Advise and assist in presentations to rating agencies.
- Engaging third party providers such as Trustee/Paying agents, bond insurers, printers and verification agents.
- Assist in developing a formal debt policy which incorporates the City's financial and operational objectives.
- Undertake such additional actions as will lead to the prompt and successful delivery of the proceeds and the bonds at closing.

The Board of Mayor and Aldermen shall approve the written agreement between the City and the municipal advisor with respect to a debt transaction. The municipal advisor shall not be permitted to bid on or underwrite an issue for which it has been providing advisory services.

15. Disclosure

To the extent any outstanding bond or debt obligation so requires, the City will provide annual financial and economic information as required by the Municipal Securities Rulemaking Board or the Securities and Exchange Commission, according to the Disclosure Certificate. It shall be the responsibility of the City Mayor and City Recorder to monitor this compliance.

Legal Counsel - The City will enter into an engagement letter agreement with each lawyer or law firm representing the City in a debt transaction. No engagement letter is required for any lawyer who serves as counsel to the City regarding City matters generally. Bond counsel for each debt transaction is contracted by the City Mayor and serves to assist the City in such debt issue.

16. Debt Policy Review

The Debt Policy guidelines outlined herein are only intended to provide general direction regarding the future use and execution of debt. The City maintains the right to modify these guidelines and may make exceptions to any of them at any time to the extent that the execution of such debt achieves the City's goals.

This Policy will be reviewed no less frequently than annually. At that time the Board of Mayor and Aldermen will consider any recommendations for any amendments, deletions, additions, improvements, or clarification.

17. Disclosure of Costs

The City requires all professionals engaged to assist in the process of issuing debt to clearly disclose all compensation and consideration received related to services provided in the debt issuance process by the City in a timely manner. This includes "soft" costs or compensations in lieu of direct payments.

18. Potential Conflicts of Interest

Professionals involved in a debt transaction hired or compensated by the City shall be required to disclose existing client and business relationships between and among the professionals to a transaction (including but not limited to financial advisor, swap advisor, bond counsel, swap counsel, trustee, paying agent, underwriter, counterparty, and remarketing agent), as well as conduit issuers, sponsoring organizations and program administrators. This disclosure shall include that information reasonably sufficient to allow the City to appreciate the significance of the relationships. Professionals who become involved in the debt transaction as a result of a bid submitted in a widely and publicly advertised competitive sale conducted using an industry standard, electronic bidding platform are not subject to this disclosure. No disclosure is required that would violate any rule or regulation of professional conduct.

19. Transparency

The City shall comply with the Tennessee Open Meetings Act, providing adequate public notice of meetings. Additionally, in the interest of transparency, all costs (including interest, issuance, continuing, and one-time) shall be disclosed to the citizens in a timely manner. An estimate of the costs described above will be presented to the Board of Mayor and Aldermen along with any resolution authorizing debt.

Within four weeks of closing on a debt transaction, the debt service schedule and the State Form CT-0253 shall be available at the office of the City Recorder for review by members of the Governing Body and the public.

20. Debt Administration - Post Sale

(a) The City Recorder will maintain for review by members of the Board of Mayor and Aldermen and the public a report describing the transaction and setting forth all the costs associated with the transaction.

(b) The municipal advisor will provide a closing memorandum with written instructions on transfer and flow of funds.

(c) The City Recorder will establish guidelines and procedures for tracking the flow of all bond proceeds, as defined by the Internal Revenue Code, over the life of bonds reporting to the IRS all arbitrage earnings associated with the financing and any tax liability that may be owed.

(d) Compliance with arbitrage requirements on invested tax-exempt bond funds will be maintained. Proceeds that are to be used to finance construction expenditures are exempted from the filing requirements, provided that the proceeds are spent in

accordance with requirements established by the IRS. The City will comply with all of its tax certificates for tax-exempt financings by monitoring the arbitrage earning on bond proceeds on an interim basis and by rebating all positive arbitrage when due, pursuant to Internal Revenue Code Section 148. The City will contract with an arbitrage consultant to prepare these calculations, when needed. The City will also retain all records relating to debt transactions for as long as the debt is outstanding, plus three years after the final redemption date of the transaction.

- (e) Compliance with private activity requirements with respect to tax exempt debt-financed facilities will be maintained. The City Recorder shall maintain a record of the allocation of debt proceeds to expenditures, and monitor the use of tax exempt debt-financed facilities to ensure that no impermissible private use occurs.
- (f) Any proceeds or other funds available for investment by the City must be invested pursuant to applicable State law.

EXHIBIT A

Ratios and Standards

1. Net Debt Per Capita: Total par amount of Debt of City less Service Fund Balance and revenue supported debt, divided by its population.
 - Benchmark as established is a goal to have no more than \$2,100 in net debt per-capita at any given time.
2. Net Debt to Assessed Property Value: Net Debt divided by Assessed Property Value.
 - The overall Net Debt to Assessed value should not exceed 9.5% of Assessed Value.
3. Ratio of Debt Expenditures to Total Government Expenditures (Government Expenditures excludes capital & agency Funds)
 - Ratio should not exceed 9.5%.
4. Funds Available for Debt Service: Total of General Fund Balance, Sales Tax Fund Balance and Debt Service Fund Balance.
 - Benchmark shall be no more than 13 months of the monthly debt service requirements with a minimum of 50% of annual debt service expenditures.
(Current balance is approximately 44%, property tax rate has been increased and funds are now being rebuilt after several years of negative growth during national economic downturn.)