



# City of Sedona

## Debt Management Policy

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### **Purpose and Objective**

The City of Sedona, Arizona (the “City”) is committed to sound fiscal management practices, ensuring the City’s debt obligations are structured prudently, transparently, and in a way that best serves the public interest. This Debt Management Policy (the “Policy”) is designed to provide guidelines for the issuance of bonds and other forms of indebtedness to finance necessary land acquisitions, capital improvements, and other items for the City. While the issuance of debt is frequently an appropriate method of financing capital projects and major equipment acquisitions, such issuance must be carefully monitored to preserve the City’s credit strength and to provide the necessary flexibility to fund future capital needs. Since a debt issuance obligates the City for a significant period, identifying an appropriate revenue source for such repayment will be carefully considered prior to any issuance of debt.

The City’s high underlying revenue bond credit rating (currently “AA-” (S&P)) results in historically low tax-exempt interest rates on its debt (subject to market conditions). In turn, these low interest rates result in a lower overall cost of capital to the City. This Policy will assist the City in determining appropriate uses of debt financing, establish certain debt management goals and aid the City in maintaining its high credit rating, while assuming a prudent level of financial risk and preserving the City’s flexibility to finance future capital improvement projects and requirements.

### **Scope and Applicability**

This Debt Policy shall govern the issuance and management of all debt and lease financings funded in the capital or private placement markets. While adherence to the Policy is desired, the City recognizes that changes in the capital or private placement markets as well as unforeseen circumstances which may from time to time produce situations that are not covered by this policy and may require modifications or exceptions to achieve City goals.

The City’s Policy shall be reviewed and updated as necessary, by the Director of Financial Services. The Director of Financial Services, with the assistance of the Financial Services Department staff, shall have the responsibility and authority for structuring, implementing and managing the City’s debt and financing program, in accordance with City Council authorizations.

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## Assessing the Financing Needs of the Capital Program

The City's Financial Services Department, in collaboration with other departments, is responsible for developing the five-year capital improvement program that is approved annually by the City Council. The capital improvement program provides the basis for determining long-term capital needs of the City and may be supplemented with longer term capital improvement plans or master plans when appropriate. The Financial Services Department shall work with other City departments to develop a financial forecast related to the capital improvement programs to identify the optimal method to finance the program, including the issuance of bonds. The Financial Services Department is responsible for reviewing the funding sources and financial forecast to ensure their adequacy in complying with existing bond covenants, debt limits and the potential impact on existing bond ratings prior to the issuance of any new debt.

## Debt Issuance Guidelines

The City will issue debt only when necessary to finance capital projects that cannot be fully funded with current revenues or reserves or when in the best interest of the City to create intergenerational equity on projects that will benefit future taxpayers or ratepayers. Debt issuance should be structured to optimize long-term financial health, minimize costs and maintain flexibility while considering the City's debt capacity.

### Structure of Debt

**Maturity.** The final maturity of a bond sale shall be equal to or less than the remaining useful life of the assets being financed. Per U.S. Treasury Regulations under the Internal Revenue Code, the average amortized life of the financing shall not exceed 120% of the average useful life of the assets being financed. 26 USC §147(b)(1)

**Debt Service Structure.** Financial Services will carefully consider the debt service structure for each bond issue. Factors such as the flow of revenues available for a particular credit, the need to fill in gaps created by refunding specific principal maturities or to structure savings from a refunding in a particular year will be considered.

Accelerated repayment may be considered within the bonding capacity constraints to provide capacity for future capital programs. Bonds will be amortized over a period not to exceed the useful life of the assets being financed.

**Lien Levels.** Senior, Junior, and Subordinated Junior Liens for each revenue source will be utilized in a manner that will maximize the most critical constraint, typically either cost or capacity, allowing for the most beneficial use of the revenue source securing the bond.

**Capitalized Interest.** Subject to Federal and State law, interest may be capitalized. Any use of capitalized interest will require a review by bond counsel and approval by the Director of Financial Services.

### Debt Capacity

The Arizona Constitution Article IX § 8(1) establishes the maximum bonded indebtedness of a City that is backed by property taxes. The City of Sedona does not levy a property tax for operations or bond repayment. Any levy of property tax, for operations or bond repayment, requires voter approval under A.R.S. §42-17056.

The City of Sedona issues revenue debt, or bonds secured by sales and/or bed tax revenue, or utility rates. The maximum debt that can be backed by these revenue streams is determined not by legislation but by debt coverage ratios, bond covenants and the long-term financial outlook of the issuer.

**Evaluating Capacity for Revenue Debt.** While revenue debt bond covenants set a minimum coverage ratio over the life of the debt, to evaluate the City's capacity for additional debt the City shall develop long-term forecasts of expenditures, cash flow requirements for operational and debt service needs and revenues.

*Utility Revenue Debt.* The issuance of utility revenue debt shall begin with a rate study to evaluate the operational and capital needs of the system. The results of the rate study will then be used to determine the required long-term cash flow to cover operations and debt service for necessary capital investment and to adjust customer rates to meet the cash flow needs.

*Excise Tax Revenue Debt.* Issuing debt that is backed by the excise taxes collected by the City requires the following:

- Expenditure forecasts to determine necessary revenue for ongoing operations, capital spending and debt service:
  - Operating expenditure forecast,
  - Capital plan, including cost, timing, and intended funding mechanism (i.e., pay-as-you-go, debt financed), and
  - Bond issuance and debt service forecast.
- Cash flow requirements
  - To cover debt service as forecast,
  - To meet bond covenant requirements, and
  - To ensure adequate cash for operations and pay-as-you-go capital spending.

- Forecast of revenue to estimate the available revenue to cover ongoing operations, capital spending and debt service:
  - Revenues to be pledged to cover the debt and meet bond covenants,
  - “Excess” within pledged revenue stream available for ongoing operations, and
  - Other (non-pledged) revenue streams available for operations and pay-as-you-go capital investment.

Revenue forecasts shall be scenario-based and updated regularly to ensure that changes in economic conditions do not impact the ability of the City to cover debt service and comply with bond covenants.

### Methods of Debt Issuance

**Evaluating the Method of Debt Issuance.** It shall be the policy of the City for the Director of Financial Services to oversee the evaluation of the type of each bond sale and determination of the most beneficial method of sale considering the issuer characteristics and financing characteristics. The following guidelines may be used to determine the most suitable method of sale amongst Private Placement, Competitive Public Bond Sale or Negotiated Public Bond Sale. The City has historically utilized both the private placement market and the public sale market through negotiated bond sales.

#### **Private Placement vs. Public Sale of Bonds:**

**Private Placement Transactions.** A private bank Installment Purchase Obligation [cities do not have statutory authority to enter into a bank loan] or traditional Lease Purchase financing may be considered when the City may need to issue debt quickly, desires to have flexible repayment terms including call features, or requires financing for smaller projects. The City’s Director of Financial Services will consider the interest rate, loan terms, and any covenants that may limit the City’s operational flexibility. The City’s Financial Services Department may consult with its Bond Counsel and a Placement Agent to solicit bids and evaluate and negotiate proposed financing terms.

**Public Sale of Bonds.** When the City’s financing needs are larger, a public bond sale will be preferred. The method of a public bond sale can be either **competitive sale** or **negotiated sale**, depending on market conditions and the specific timing and nature of the financing.

**Competitive Sale.** The Director of Financial Services, or their designee, could consider a competitive sale if the City is issuing bonds that are considered attractive to a broad range of investors, such as General Obligation Bonds or large revenue bond issuances. In a competitive sale, bond underwriting firms submit bids, and the firm with the lowest True Interest Cost (TIC) and in compliance with the bid parameters is awarded the bonds. The City

may issue debt through a competitive sale when feasible to ensure the lowest overall interest rate to the City; however, it is not always practical to issue bonds through a competitive sale and may not always result in the lowest overall interest rate that could be garnered by a negotiated sale. For example, a competitive sale may not be optimal with complex credits, variable rate debt and specialized financings.

**Negotiated Sale.** The Director of Financial Services, or their designee, could consider a negotiated sale if the City requires specialized expertise from an underwriter or the market conditions are less favorable. Negotiated sales provide the City flexibility in the timing of the bond sale to adjust day-to-day to consider socioeconomic changes including the interest rate environment and economic calendar. A negotiated sale is particularly appropriate for complex projects, such as new revenue bonds or projects where investor demand is uncertain.

In a negotiated sale, the City's Director of Financial Services selects a qualified underwriter or underwriter syndicate. The City may create a qualified underwriter list through a Request for Qualifications process or a Request for Proposal process, including a consortium RFP. Underwriter compensation and interest rates are negotiated prior to the sale, based on the RFP terms and market conditions.

### Rating Agencies

The City seeks to obtain and maintain the highest possible credit ratings for all categories of short and long-term debt.

**Rating Agency Relationships.** The Director of Financial Services, or their designee, shall be responsible for maintaining relationships with rating agencies that assign ratings to the City's various debt obligations. This responsibility shall include coordinating meetings and presentations in conjunction with the issuance of debt. Full disclosure of operations and open lines of communication shall be maintained with the rating agencies used by the City throughout the life of the debt obligations. The City currently maintains an "AA-" (2025) underlying credit rating from S&P relative to its outstanding Excise Tax Revenue Obligations. The Rating agency will conduct periodic surveillance ratings throughout the term of the bond transaction.

**Use of Rating Agencies.** The City shall consider a rating from at least one nationally recognized rating agency on all new bond issues being sold in the public market. The Director of Financial Services, or their designee, shall determine whether or not any additional ratings will be requested on a particular financing. The Director of Financial Services, or their designee, shall determine which major rating agencies will be asked to provide a rating.

The City or its professionals retained to assist shall notify the rating agencies when the City anticipates issuing bonds. A personal meeting with the selected rating agencies may be scheduled if, in the opinion of the Director of Financial Services, or their designee, such a meeting is in the best interest of the City to obtain the highest possible credit rating. Additionally, the City shall:

- Make every reasonable effort to maintain or improve its credit ratings;
- Request an underlying rating and an insured rating on all bond issues using bond insurance; and
- Submit its audited annual comprehensive financial report to all rating agencies used by the City.

### Bond Insurance / Credit Enhancement

Although the City of Sedona has a high revenue bond underlying credit rating, credit enhancement through the use of bond insurance to strengthen the underlying credit rating of certain bonds may be financially beneficial through lower interest rates in the market.

The steps below will be followed if the City considers bond insurance for a bond issue.

- Benefit Analysis. The decision to use bond insurance is an economic decision. A benefit analysis compares the present value of the interest savings to the cost of the insurance premium. Insurance may be purchased when the premium cost is less than the present value of the projected interest savings. A copy of the benefit analysis shall be maintained in the files of the Financial Services Department.
- Provider Selection. The City or its municipal advisor will undertake a competitive selection process when soliciting pricing for bond insurance, or in the case of a competitive sale, facilitating the prequalification of bonds by insurance providers. The City recognizes that all providers may not be interested in providing bids to the City or pre-qualifying the issue. The winning security dealer in a competitive sale will determine whether it will purchase insurance for the issue. For a negotiated sale, the Director of Financial Services shall have the authority to purchase bond insurance when deemed advantageous and the terms and conditions governing the guarantee are satisfactory.

### Service Providers

**Selection of Service Providers for Debt Issuance.** In connection with debt financings, municipal advisors, underwriters, bond counsel and other service providers will be selected from a Qualified Vendor List (QVL) developed through a periodic Request for Qualifications

(RFQ) process, or, for individual financings, through a Request for Proposal (RFP) process or through a consortium RFP of qualified firms, whichever method is deemed most appropriate given the specifics of the financing. At the discretion of the Director of Financial Services, contracts may be awarded on a sole source basis if the RFP method is not feasible or in the best interest of the City. If the RFP process is deemed most appropriate given the specifics of the financing, the City will request quotes from service providers selected from the QVL.

For competitive sales, any security dealer meeting the qualification criteria outlined in the competitive bid notice may bid in the competitive sale. For negotiated sales, only those underwriters qualified under the RFQ process and placed on the QVL may be selected. Underwriters or underwriter syndicates will be approved by the Director of Financial Services, and the allocation of bonds among syndicate members will be at their sole discretion.

**Use of Independent Municipal Advisors.** The City of Sedona shall only hire municipal advisors who are registered with the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB), per section 15B of the Securities Exchange Act. If the City engages a municipal advisor that is also an investment banking firm, under no circumstances shall the firm be permitted to participate as the lead underwriter or as a member of an underwriting syndicate that is bidding on the bonds for which the firm is acting as a municipal advisor. In general, no agreement will be permitted that would compromise the firm's ability to provide independent advice or that could be reasonably perceived by the City as a conflict of interest. Advisors must alert the Director of Financial Services, in writing, of any conflict, potential conflict, or potentially perceived conflict prior to entering into an agreement with the City, or if occurring after entering into an agreement with the City, as soon as the conflict, potential conflict, or potentially perceived conflict arises.

**Communications/Solicitation.** All consultants, including all investment banking firms, municipal advisors, bond counsel, and other consultants hired in connection with any bond transaction will direct all communications, solicitations and questions to the Director of Financial Services, or their designee.

Any underwriting firm may be banned from providing underwriting services to the City for two (2) years for making any political contributions to elected officials of the City. (MSRB Rule G-37).

## Ongoing Requirements and Review

### Continuing Disclosure and Compliance

**Continuing Disclosure Requirements.** The City will comply when applicable with Rule 15(c)2-12 of the Securities and Exchange Commission and the respective continuing disclosure undertaking (CDU) agreement by filing an annual report and annual financial information with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) System.

In addition to annual filings, the Rule requires dissemination of a disclosure notice when a qualifying and material event has occurred. The CDU for each bond series lists the Material Events for which the City has covenanted to file and reflects the Material Events which the Rule required at the time of issuance. The City will file a Material Event notice on EMMA within the required time period as required by the Rule.

The Director of Financial Services will determine when an event will be voluntarily disclosed on EMMA, and may consult with bond counsel, financial advisors, and City management to determine whether to post a voluntary notice.

**Post-Issuance Compliance.** The City shall comply with all applicable laws and regulations to ensure the tax-exempt status of its bonds is maintained. The Financial Services Department shall maintain written procedures to document the processes used to ensure compliance with applicable laws and regulations and shall specify the positions and individuals responsible for these processes.

### Refunding Bonds

The Financial Services Department will undertake a periodic review of the City's outstanding debt to determine refunding opportunities.

As defined, refunding bonds are issued to retire all or a portion of an outstanding bond issue. Most typically this is done to refinance at a lower interest rate to reduce overall debt service. Alternatively, some refunding's are undertaken for reasons other than to achieve cost savings, such as to restructure debt service payments, to change the type of debt instruments being used, or to eliminate undesirable covenants. With most refunding's, the City will keep the same credit lien and amortization period of the bonds that are being refunded. The City will consider whether it may be advantageous to change the lien on the refunding bonds if it creates more favorable pricing or preserves future lien capacity.

A net present value savings analysis will be prepared that identifies the economic effects of any refunding being considered by the City. The savings from any refunding shall generally be

at least three percent (3%) of the refunded par amount, net of all transaction expenses. This savings target may be waived by the Director of Financial Services, or their designee, upon a finding that the refunding is in the City's best interest for refunding transactions that are not solely undertaken to achieve cost savings.

### **Arbitrage Rebate**

The City of Sedona shall comply with all arbitrage rebate requirements as established by the Internal Revenue Service. The Financial Services Department shall establish a system of record keeping and reporting to meet the arbitrage rebate compliance requirements of the federal tax code. This effort shall include tracking project expenditures financed with bond proceeds, tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebateable earnings to the federal government in a timely manner to preserve the tax-exempt status of the City's outstanding tax-exempt debt issues. Rebate, if any, is due to the U.S. Treasury on the fifth anniversary date of each closing of a transaction. The Director of Financial Services, or their designee, may enter into agreements with arbitrage service providers to assist with the City's compliance of arbitrage regulations.

### **Effective Date**

This policy shall be effective immediately upon approval by the City Council of the City of Sedona and shall remain in effect until amended or rescinded by the City Council.

Arizona City/Town Financing Alternatives Summary – Public Infrastructure Projects

Type of Infrastructure Improvement	General Obligation Bonds	Excise Tax Revenue Bonds	Utility Revenue Bonds	WIFA/USDA
1. Streets and Roads (Transportation)	✓	✓		
2. Parks, Recreation and Open Space / Land Acquisition	✓	✓		
3. Water and Wastewater Utilities (Acquisitions and Improvements)	✓	✓	✓	✓
4. Police and Fire Improvements (Public Safety)	✓	✓		
5. Land Acquisition / Administrative Facilities (i.e., City Hall / Community Center)	✓	✓		
6. Libraries	✓	✓		
7. Equipment/Technology including <i>Energy Efficiency</i>	✓	✓	✓	✓
8. Storm Drainage / Flood Control	✓	✓	✓	✓
9. Solid Waste	✓	✓	✓	
10. PSPRS / ASRS Unfunded Pension Liability / Refunding's	✓	✓		

Public Infrastructure Debt Financing Alternatives Commonly Used in Arizona

Type of Bonds/ Promissory Note	Pledged Revenues/ Source of Repayment	Types of Projects	Bonding Capacity/Limits	Election	Commentary Regarding Alternative
1. General Obligation Bonds (G.O. Bonds)	Secondary property tax levy ( <i>Ad valorem</i> )	Virtually all public infrastructure improvements – see attached summary	26% of Net Full Cash Value (property tax base) Currently estimated at \$206 million for City of Sedona	Yes (Nov. only)	1. Cost to taxpayer determined by secondary property tax rate and value of property. Tax rate determined by amount of issuance and tax base of the City (Net Limited Assessed Property Value)
2. Excise Tax Revenue Obligations	Local Sales Tax Revenues (TPT), State Shared Income and Sales Tax Revenues, Vehicle License Tax, Bed Tax, Other Misc.	Virtually all public infrastructure improvements	Covenant based. Significant but based on budget capacity and/or new Local Sales Tax (TPT)	No	1. Most common financing alternative in AZ 2. Sedona Rating: “AA-” (S&P) 3. Debt service coverage covenant: 1.50x 4. Additional bonds test: 1.50x
3. Water, Wastewater Utility Obligations	Water and WW Utility net revenues	Utility improvements  Utility Acquisition Projects (Water and WW)	Limited to bond covenants  Utility rate adjustments considered	No	1. Repaid generally from the City’s Utility Enterprise System (net revenues after payment of maintenance and operation) or from excise taxes 2. Utility rate adjustments may be required
4. WIFA Loan (Water and WW eligible)  State Agency Bond Bank	Water and WW Utility net revenues	Utility improvements  Utility Acquisition Projects (Water and WW)	Limited to bond covenants	No	1. Davis-Bacon federal wage and buy American steel requirements, possible grants, subsidized interest rates, annual compliance requirements 2. Requires careful cost benefit analysis
5. Lease-Purchase/ Certificates of Participation (COPs)	General Fund – Annual Budget Appropriation Real Property Collateral	Generally used on highly essential public purpose projects	Generally based on budget capacity and/or new Local Sales Tax (TPT)	No	1. Generally one notch lower in credit rating due to annual appropriation budget requirement 2. Available option for capacity restraints

Economic Development Debt Financing Alternatives – CFDs, RDs & IDs

Type of Entity/Jurisdiction	New Political Subdivision	Types of Projects	Types of Bonds	Election	Commentary Re. Alternative
Community Facilities Districts (CFDs)	Yes City Council generally serves as the Board of Directors	Master Planned Residential Projects Commercial/Industrial Projects Virtually all public infrastructure projects	General Obligation Bonds (secondary property tax) Special Assessment Revenue Bonds (per acre/per lot fixed assessment)	Yes – by property owners within proposed District to form and secure general obligation bond authorization	<ol style="list-style-type: none"> <li>1. Formed by the City, generally at the request of a developer/homebuilder</li> <li>2. Complicated transactions that require significant due diligence</li> <li>3. Developer constructs infrastructure and subsequently seeks reimbursement through the CFD</li> <li>4. No City general fund backup in the event of default</li> </ol>
Revitalization Districts (RDs)	Yes Outside Board of Directors – not the City Council	Same as above	Special Assessment Bonds	No	<ol style="list-style-type: none"> <li>1. Formed by the City generally at the request of a developer/homebuilder</li> <li>2. Complicated transactions that require significant due diligence</li> <li>3. Only one formed in the State</li> </ol>
Improvement Districts (IDs)	No	Utilities/roads/streets/parking garages	Special Assessment Bonds – Lien allocated to each property owner based on equitable benefit	No	<ol style="list-style-type: none"> <li>1. Public Private Partnership Economic Development tool</li> <li>2. Landowners agree to formation – 100% participation generally required – not a city-wide assessment</li> <li>3. Special assessment transfers with the sale of real property</li> <li>4. Special Assessment Bonds generally require high grade credits due to City general fund backup requirement</li> </ol>

Bond Ratings Chart<sup>1</sup>

FEATURES	MOODY'S	S&P	FITCH
Best Quality	Aaa	AAA	AAA
High Quality	Aa1 Aa2 Aa3	AA+ AA AA-	AA+ AA AA-
Upper Medium Quality	A1 A2 A3	A+ A A-	A+ A A-
Medium Grade Quality	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-
Sub-prime (Junk Bonds)	Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-

1. The City’s underlying revenue bond credit rating (currently “AA-” (S&P)) is considered high quality.