

**CITY OF FAIR OAKS RANCH
DEBT MANAGEMENT POLICY**

I. POLICY

The City of Fair Oaks Ranch Debt Management Policy (this “Policy”) provides a framework for managing the City’s debt. This Policy sets parameters for issuing new debt, managing outstanding debt, maintaining acceptable debt levels, and preserving bond ratings to minimize borrowing costs. It guides decisions on issuing and managing debt while supporting the City’s goal of long-term financial stability.

II. SCOPE

This Policy applies to all debt instruments issued by the City regardless of funding source. Funding sources may come from ad valorem taxes, general revenues, enterprise fund revenues, or other pledged revenues for bonded indebtedness.

III. OBJECTIVES

The primary objectives of this Policy are to maintain long-term financial stability, ensure debt is used only for capital improvements and long-term assets, and not for operations. Key objectives include:

- i. Project revenues conservatively to ensure repayment.
- ii. Match debt maturities to the useful life of projects or legal limits.
- iii. Decisions will consider multiple factors and be evaluated in the context of long-term plans and goals, rather than short-term needs.
- iv. Debt service funds will be managed and invested in compliance with federal, state and local laws as well as the City’s Investment Policy.

IV. USE OF DEBT FINANCING

The City may use debt financing for the purchase of capital assets, infrastructure improvements, or additions that cannot prudently be financed by either current revenues, direct fees, or reserves. Long-term debt will not be used to fund current operating expenditures or annual operations. The term of debt issued by the City will not exceed the useful life of the capital expenditure for which the borrowing occurred. Alternative financing sources will be explored before debt is issued to limit the amount of borrowing.

Short-term debt for operations will generally be avoided, except in cases of reliable short-term repayment sources or emergencies.

V. FEASIBILITY & CAPACITY FOR DEBT

Debt should be used within the City's legal and financial capacity. City Council will consider recommendations from the City Manager and Finance Director before authorizing new debt. The Finance Director will keep the City Council and the City Manager informed of outstanding debt levels, impacts of new issuance, and long-term capacity. Debt capacity analyses may be performed as needed.

When feasible, the City will use available cash to reduce borrowing. When evaluating how to fund capital expenditures or improvements, the City will weigh both pay-as-you-go financing and debt financing. The choice of method will depend on financial capacity, market conditions, project urgency, and long-term creditworthiness.

A. Pay-As-You-Go Financing may be favored when:

- i. Projected revenues and fund balances are sufficient to fund the expenditure without materially reducing financial metrics such as cash-on-hand or the debt service coverage ratio.
- ii. Using City resources will not impair the City's credit ratings or outlook.
- iii. Additional debt could adversely impact the City's credit ratings or repayment capacity.
- iv. Market conditions or interest rates are unfavorable for issuing debt.
- v. Circumstances require deferring debt financing even if preferred.
- vi. The timing of funding for improvements remains uncertain.

B. Debt Financing may be favored when:

- i. Projected revenues and fund balance are insufficient to fund the expenditure without materially affecting cash-on-hand or coverage ratios.
- ii. Revenues available for debt service are sufficient and reliable to ensure repayment while maintaining investment-grade ratings.
- iii. Market conditions support favorable interest rates and debt issuance.
- iv. A project is legally mandated (federal/state law, settlement or administrative action) and current resources cannot meet the required time frame.
- v. A project is urgently required to address capacity needs or emergency conditions, and existing resources are not sufficient.

VI. TYPES OF AUTHORIZED DEBT

The City has several financing tools available to support capital improvements and major expenditures. The following outlines the primary types of long-term debt instruments that may be considered and the circumstances under which each may be used.

A. General Obligation Bonds

Require voter approval and are secured by property taxes. Bond proposals will be structured within the City's ability to issue and service debt under this Policy and will consider existing obligations and the five-year Capital Improvement Plan.

B. Certificates of Obligations

May be issued as allowed by state law, particularly for public works or capital improvements. Enterprise Fund projects must demonstrate the ability to support repayment from fund revenues or other pledged sources (not ad valorem taxes). Certificates do not require an election but remain subject to voter referendum.

C. Revenue Bonds

Issued for making improvements to enterprise funds that are responsible for repayment. Except as otherwise required by law, voter approval is not necessary. Revenues must meet coverage ratios defined in this Policy or required by market conditions then present, with rate adjustments made as needed to maintain compliance.

D. Capital Leases

May be used for equipment acquisitions when cost-effective or necessary due to budget constraints or vendor terms. Leasing is not preferred when cash is available unless interest savings or other factors justify. All lease agreements require City Council approval.

E. Tax Notes

May be issued for legally allowable purposes, including interim financing during construction or to manage debt service. Maturity will not exceed seven years from issuance.

F. Other Debt

Other instruments may be considered when appropriate, subject to case-by-case evaluation and guidance from the City's municipal advisors.

VII. STRUCTURE OF DEBT

In general, debt will be structured to:

- i. Stay within the City's financial capacity.
- ii. Minimize property tax impact.
- iii. Match terms to the useful life of financed assets or legal limits.
- iv. Use level or declining repayment schedules, avoiding balloon payments.
- v. Limit variable-rate exposure to reduce risk.

VIII. DEBT LIMITATIONS

The following ratios and standards serve as guidelines to preserve long-term access to capital while ensuring that debt decisions remain affordable and do not negatively impact operations. These limitations provide a framework for evaluating the impact of additional debt issuance.

A. Legal Limits

The City will comply with the Texas Constitution, Article XI, Section 5, which limits the total tax rate of cities with populations over 5,000 to \$2.50 per \$100 of assessed valuation. The City will also adhere to the Texas Attorney General's administrative policy, which generally prohibits municipalities from issuing debt if requirements exceed what can be paid from a \$1.50 maximum tax rate, calculated at 90 percent collection rate. The \$1.50 is part of the overall \$2.50 constitutional limit.

B. Self-Supported Debt

Debt issued by enterprise funds will maintain a minimum debt service coverage ratio of 1.00 on all outstanding indebtedness. For this purpose, the ratio is defined as the enterprise fund's net revenue from the prior fiscal year (per the most recent ACFR) divided by the maximum annual debt service on all outstanding enterprise fund debt, including the proposed issuance.

IX. REFUNDING AND CASH DEFEASANCE

The City shall monitor opportunities to refund debt when savings are at least 3% of outstanding costs, inclusive of issuance expenses. Refunding may also be considered for restructuring or covenant changes. Cash defeasance may be used to manage the tax rate.

X. BOND ELECTIONS

Timing of bond elections will consider authorized but unissued bonds and the five-year Capital Improvement Plan. Bond amounts recommended to voters will not exceed the City's ability to issue within seven years. Each proposal will include analysis of impacts on the City's tax rate and debt capacity.

XI. METHODS OF SALE

The City will generally sell debt through a competitive bidding process. A negotiated sale or private placement may be used when market conditions, issue complexity, or refinancing needs make those methods more advantageous. Refinancings that rely on market or interest rate timing may also warrant a negotiated or private placement approach.

Except in cases of negotiated sales or private placements, bonds will be awarded based on True Interest Cost (TIC), provided all other bidding requirements are met. TIC is defined as the rate that discounts the aggregate debt service payments over the life of the bonds to their present value as of the delivery date.

Considerations in determining the method of sale include:

- a) Financial conditions

- b) Market conditions
- c) Complexity of the issue
- d) Transaction-specific or City-related conditions
- e) Volatility of bond yields
- f) Underwriters' familiarity with the City's credit quality
- g) Size of the issue
- h) Prior experience
- i) Risks associated with each method

XII. CREDIT RATINGS AND DISCLOSURE

The City will maintain strong relationships with nationally recognized bond rating agencies and provide timely disclosure of annual financial and other relevant information. The City will obtain a rating from at least one nationally recognized agency for all publicly sold debt to preserve or improve its bond rating, minimize borrowing costs, and maintain creditworthiness.

XIII. INVESTMENT OF BOND PROCEEDS

Bond proceeds will be invested in accordance with the City's Investment Policy and applicable bond covenants, either separately or within pooled cash.

XIV. DEBT MANAGEMENT & COMPLIANCE

A. Financial Advisor

The City may retain a financial advisor with broad municipal debt experience and diverse structuring expertise. The advisor must be in good standing with the SEC and provide objective guidance to secure the best pricing and service.

B. Underwriter

Through the financial advisor, the City may engage qualified underwriting firms. The advisor, in coordination with the City, will recommend syndicate structures best suited to each issuance.

C. Other Service Providers

The City may select other service providers as necessary to meet legal requirements and minimize debt costs.

D. Compliance

The City will comply with all bond covenants and federal, state, and local requirements. This includes timely disclosure, adherence to IRS arbitrage regulations, and use of debt proceeds within required timeframes. Arbitrage interest earned on bond proceeds above the interest cost will be monitored to ensure compliance and preserve the tax-exempt status of City debt. The City will maintain recordkeeping and reporting systems to meet all arbitrage rebate requirements.

E. Financial Reporting

The finance department is responsible for providing annual disclosures to national information repositories, maintaining compliance with federal and state requirements, and preparing all debt-related schedules and footnotes for the City's annual financial statements.

XV. POLICY REVIEW

This Policy will be reviewed periodically by the Finance Director. All modifications require Council approval.