

Tennessee Local Development Authority



Debt Management Policy

Prepared by
Office of State and Local Finance

Table of Contents

Introduction.....	1
Goals and Objectives.....	2
Debt Management/General.....	3
Types of Debt.....	4
Debt Management Structure.....	5
Refinancing Outstanding Debt.....	5
Methods of Sale.....	6
Selection of Underwriting Team.....	7
Credit Quality.....	8
Credit Enhancements.....	8
Risk Assessment.....	10
Transparency.....	10
Professional Services.....	10
Potential Conflicts of Interest.....	11
Debt Administration.....	11
Federal Regulatory Compliance and Continuing Disclosure.....	12
Review of the Policy.....	13
Adoption of the Policy.....	13

Debt Management Policy

Introduction

Debt management policies provide written guidance about the amount and type of debt issued by governments, the issuance process, and the management of the debt portfolio. A debt management policy tailored to the needs of the Tennessee Local Development Authority (the “Authority”): (1) identifies policy goals and demonstrates a commitment to long-term financial planning; (2) improves the quality of decisions; and (3) provides justification for the structure of debt issuance. Adherence to its debt management policy signals to rating agencies and the capital markets that the Authority 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 the Authority to manage its debt program in line with those resources.

In 1978, the General Assembly created the Authority [Sections 4-31-101 et seq., Tennessee Code Annotated]. The Authority is a corporate governmental agency and instrumentality of the State of Tennessee (the “State”). The Authority is comprised of the Governor, the Secretary of the State, the State Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, a Senate appointee and a House appointee.

The Authority is authorized to issue debt to (i) loan funds to local governments for sewage treatment and waterworks (the “State Loan Programs”), capital projects, firefighting equipment, and airport facilities; (ii) loan funds to certain small business concerns for pollution control equipment; (iii) make funds available for loans for agricultural enterprises; (iv) make loans to not-for-profit organizations providing certain mental health, mental retardation, and alcohol and drug services (the Community Provider Pooled Loan Program or the “CP Program”); (v) make loans to local government units to finance construction of capital outlay projects for K-12 educational facilities; (vi) make payment on covered claims against insurers operating in this state which have been deemed insolvent as the result of a natural disaster; and (vii) make the proceeds available to petroleum underground storage tank board for purposes of providing for the reimbursement of reasonable and safe cleanup of petroleum sites. The aggregate amounts outstanding for certain programs are limited as follows: \$10,000,000 for firefighting equipment; \$200,000,000 for airport facilities; \$50,000,000 for pollution control equipment; \$50,000,000 for mental health, mental retardation, and alcohol and drug services; \$30,000,000 for agricultural enterprises; \$15,000,000 for petroleum underground storage tank cleanup costs; and \$75,000,000 for capital outlay projects for K-12 educational facilities.

The Authority issues debt only pursuant to the provisions of the TLDA State Loan Programs General Bond Resolution adopted by the Authority on August 3, 1982 as amended and supplemented and restated and readopted on March 14, 1985 and as amended on May 17, 1989. This Policy applies only to that program.

Goals and Objectives

The Authority is establishing a debt policy as a tool to ensure that financial resources are adequate and that financings undertaken satisfy certain clear objective standards designed to protect the Authority's financial resources and to meet its program capital needs.

A. The goals of this policy are:

1. To document responsibility for the oversight and management of debt related transactions;
2. To define the criteria for the issuance of debt;
3. To define the types of debt approved for use within the constraints established by the General Assembly;
4. To define the appropriate uses of debt;
5. To define the criteria for evaluating refunding candidates or alternative debt structures; and
6. To minimize the cost of debt.

B. The objectives of this policy are:

1. To establish clear criteria and promote prudent financial management for the issuance of all debt obligations;
2. To identify legal and administrative limitations on the issuance of debt;
3. To ensure the legal use of the Authority's debt issuance authority;
4. To maintain appropriate resources and funding capacity for present and future capital needs;
5. To protect and enhance the Authority's credit rating;
6. To evaluate debt issuance options;
7. To promote cooperation and coordination with other stakeholders in the financing and delivery of services;
8. To manage interest rate exposure and other risks; and
9. To comply with Federal Regulations and Governmentally Accepted Accounting Principles ("GAAP").

Debt Management/General

A. Purpose and Use of Debt Issuance

Debt is to be issued pursuant to the authority of and in full compliance with provisions, restrictions and limitations of the Constitution and laws of the State (including Title 4, Chapter 31, and Title 68, Chapter 221, Parts 2 and 5, Tennessee Code Annotated), pursuant to resolutions adopted by the Authority.

1. Prior to the issuance of bonds, bond anticipation notes may be issued for the payment of costs of projects as authorized by the bond authorization and a resolution of the Authority.
2. Bonds may be issued to refinance outstanding debt.

B. Limitations

The dollar amount of debt that the Authority may issue and that may be outstanding for the State Loan Programs is not limited by statute; however, debt issued for this program shall be “limited special obligations” of the Authority payable solely from and secured by payments made by local government units, or state-shared taxes withheld, pursuant to loan program agreements.

C. Federal Tax Status

Tax-Exempt Debt – The Board will use its best efforts to maximize the amount of debt sold under this policy using tax-exempt financing based on the assumptions that tax-exempt interest rates are lower than taxable rates and that the interest savings outweigh the administrative costs, restrictions on use of financed projects, and investment constraints

D. Legal Limitations on the Use of Debt

1. No debt obligation shall be sold to fund the current operation of any state service or program.
2. The proceeds of any debt obligation shall be expended only for the purpose for which it was authorized and applied to fund loan program agreements only when the ratio of unobligated state-shared taxes complies with state statutes, including any pledge of the statutory reserve fund.
3. Notes may be issued only when the Comptroller has filed a certificate as required by TCA Section 4-31-108(f), including the certification that loan program agreements are in place that will utilize at least 75% of the note proceeds.

Types of Debt

A. Bonds

Security - The Authority may issue limited special revenue bonds, backed by payment pursuant to loan program agreements.

These bonds may be structured as:

1. **Fixed Interest Rate Bonds** – Bonds that have an interest rate that remains constant throughout the life of the bond.
 - Serial Bonds
 - Term Bonds
2. **Variable Interest Rate Bonds** – Bonds which bear a variable interest rate but do not include any bond which, during the remainder of the term thereof to maturity, bears interest at a fixed rate. Provision as to the calculation or change of variable interest rates shall be included in the authorizing resolution. Variable rate debt may be used in the following circumstances:
 - For bond anticipation notes issued during the construction period phase of a project;
 - To finance projects that have a high probability of having a change from public to private use over the period of amortization;
 - For projects requiring an extraordinary redemption period prior to a standard call date;
 - For asset liability matching purposes; and
 - To diversify the interest rate risk of the debt portfolio.

B. Short Term Debt

Pending the issuance of the definite bonds authorized by the bond authorizations, the Authority may issue short term debt in the form of bond anticipation notes. Such debt shall be authorized by resolution of the Authority. Debt issued in a short-term mode may be used to fund projects during the construction phase of the project

- **Fixed Rate Notes** – Notes issued for a period of time less than three years at a fixed interest rate that are used to fund projects during the construction period.
- **Variable Rate Notes** – Notes which bear variable interest rates until redeemed. Provision as to the calculation or change of variable interest rates shall be included in the authorizing resolution.

Debt Structure

The Authority shall establish by resolution all terms and conditions relating to the issuance of debt and will invest all proceeds pursuant to the terms of the Authority's authorizing resolution and the State's investment policy.

A. Term

The term of any debt (including refunding debt) used to purchase or otherwise obtain or construct any equipment, goods, or structures shall have a reasonably anticipated lifetime of use equal to or less than the average useful life of the project. The final maturity of the bond debt should be limited to 30 years after the date of issuance or the date the project is deemed complete or placed in service, whichever is earlier.

The final maturity of notes and any renewals is limited to eight years from the date of issue of the original notes unless the Authority the local government unit borrower has begun repayment of principal and the ultimate maturity of the notes will not exceed 30 years from the date of first issuance.

B. Debt Service Structure

Debt issuance shall be planned to achieve level debt service unless otherwise determined by the Authority. The Authority shall avoid use of bullet or balloon maturities; this does not include term bonds with mandatory sinking fund requirements.

No debt shall be structured with other than at least level debt service unless such structure is specifically approved by a majority vote of the members of the Authority.

C. Call Provisions

When issuing new debt, the structure may include a call provision that occurs no later than ten years from the date of delivery of the bonds. Call features should be structured to provide the maximum flexibility relative to cost. The Authority will avoid the sale of long-term non-callable bonds absent careful evaluation by the Authority with respect to the value of the call option.

D. Original Issuance Discount/Premium

Bonds sold with original issuance discount/premium are permitted with the approval of the Authority.

Refinancing Outstanding Debt

The Authority with assistance from the Authority's staff and Financial Advisor shall have the responsibility to analyze outstanding bond issues for refunding opportunities. The Financial Advisor will conduct an analysis of all refunding candidates at least semiannually to identify potential refunding candidates from the outstanding bond maturities. The Authority will consider the following issues when analyzing possible refunding opportunities:

A. Debt Service Savings

The bonds will be considered for refunding when:

1. The refunding of the bonds to be refunded results in aggregate present value savings of at least 4% as certified to the Authority by the Financial Advisor to the Authority, and the savings of the bonds to be refunded must be equal to or greater than twice the cost of issuance; or
2. The refunding of the bonds is necessary due to a change in the use of a project that would require a change to the tax status of the Bonds; or
3. A project is sold while still in its amortization period.

The Refunding Bond will only be executed when the Authority confirms the receipt of the certification of the Financial Advisor to the Authority and determines that the refunding of the bonds to be refunded accomplishes cost savings to the public or that such refunding is necessary to maintain compliance with the federal code.

B. Term of Refunding Issues

The Authority will refund bonds within the term of the originally issued debt. No backloading of debt will be permitted.

C. Bond Structuring

The bonds will be structured to create proportional or level debt service savings.

D. Escrow Structuring

The Authority shall structure refunding escrows using permitted securities deemed to be prudent under the circumstances and will endeavor to utilize the least costly securities unless considerations of risk, reliability and convenience dictate otherwise. The Authority will take competitive bids on any selected portfolio of securities and will award to the lowest cost provider giving due regard to considerations of risk and reliability or unless State and Local Government Securities (“SLGs”) are purchased directly from the Federal Government. The provider must guarantee the delivery of securities except for SLGs. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the Authority from its own account.

Methods of Sale

- A. **Competitive Sale** – In a competitive sale, the Authority’s bonds shall be awarded to the bidder providing the lowest true interest cost as long as the bid adheres to the requirements set forth in the official notice of sale. The competitive sale is the preferred method of sale.
- B. **Negotiated Sale** – While the Authority prefers the use of a competitive process, the Authority recognizes that some securities are best sold through negotiation. In its consideration of a negotiated sale, the Authority shall assess the following circumstances:
 - Volatility of market conditions

- Size of the bond sale
- Credit strength
- Whether or not the bonds are issued as variable rate demand obligations
- Tax status of the bonds

C. Private Placement

From time to time the Authority may elect to privately place its debt. Such placement shall only be considered for debt transactions where the size is too small or the structure is too complicated for public debt issuance and will result in a cost savings to the Authority relative to other methods of debt issuance.

Selection of Underwriting Team (Negotiated Transaction)

If there is an underwriter, the Authority shall require the underwriter to clearly identify itself in writing, whether in a response to a request for proposals or in promotional materials provided to the Authority or otherwise, as an underwriter and not as a financial advisor from the earliest stages of its relationship with the Authority 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 Authority. 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 Authority or its designated official in advance of the pricing of the debt.

A. Selection of Senior Management Team – The Authority with assistance from its staff and financial advisor shall select the senior manager for a proposed negotiated sale. The selection criteria shall include but not be limited to the following:

- Experience in selling Tennessee debt;
- Ability and experience in managing complex transactions;
- Prior knowledge and experience with the Authority;
- Willingness to risk capital and demonstration of such risk;
- Quality and experience of personnel assigned to the Authority’s engagement;
- Financing ideas presented; and
- Underwriting fees.

B. Selection of Co-Managers – Co-managers will be selected on the same basis as the senior manager. The number of co-managers appointed to specific transactions will be a function of transaction size and the necessity to ensure maximum distribution of the Authority’s bonds. The Authority will affirmatively determine the designation policy for each bond issue.

- C. Selling Groups** – The Authority may use selling groups in certain transactions to maximize the distribution of bonds to retail investors. Firms eligible to be a member of the selling group, should either have a public finance department or pricing desk located within the boundaries of the State.
- D. Underwriter’s Counsel** – In any negotiated sale of the Authority’s debt in which legal counsel is required to represent the underwriter, the appointment will be made by the Senior Manager with input from the Authority.
- E. Underwriter’s Discount** – The Authority will evaluate the proposed underwriter’s discount in comparison to other issues in the market. If there are multiple underwriters in the transaction, the Authority will determine the allocation of fees with respect to the management fee, if any. The determination will be based upon participation in the structuring phase of the transaction. All fees and allocation of the management fee will be determined prior to the sale date. A cap on management fee, expenses and underwriter’s counsel will be established and communicated to all parties by the Authority. The senior manager shall submit an itemized list of expenses charged to members of the underwriting group. Any additional expenses must be substantiated.
- F. Evaluation of Underwriter Performance** – The Authority, with assistance of the staff and the Financial Advisor, will evaluate each bond sale after completion to assess the following: costs of issuance including the underwriter’s compensation, pricing of the bonds in terms of the overall interest cost and on a maturity-by-maturity basis, and the distribution of bonds and sales credit.

Credit Quality

The Authority’s debt management activities will be conducted to receive the highest credit ratings possible, consistent with Authority’s financing objectives.

The Office of the Comptroller of the Treasury through the Office of State and Local Finance will be responsible for the communication of information to the rating agencies and keeping them informed of significant developments throughout the year. The Office of the Comptroller of the Treasury through the Office of State and Local Finance will schedule rating agency calls and/or visits prior to the issuance of bonds.

The Office of the Comptroller of the Treasury through the Office of State and Local Finance, together with the Financial Advisor, shall prepare presentations to the rating agencies to assist credit analysts in making an informed decision.

The Authority, with the assistance of the Financial Advisor, shall be responsible for determining whether or not a rating shall be requested on a particular financing, and which of the major rating agencies will be asked to provide such rating.

Credit Enhancements

The Authority will consider the use of credit enhancements on a case-by-case basis, evaluating the economic benefit versus the cost. Only when clearly demonstrable savings can be shown shall an enhancement be utilized. The Authority may consider each of the following enhancements as alternatives by evaluating the cost and benefit of such enhancements:

A. Bond Insurance

The Authority may purchase bond insurance when such purchase is deemed prudent and advantageous for negotiated sales. The predominant determination shall be based on such insurance being less costly than the present value of the difference in the interest on insured bonds versus uninsured bonds. For competitive sales, the purchaser of the bonds will determine whether bond insurance will be used and will be included in the bid for the bonds and will be paid for by the purchaser of the bonds.

The Authority will qualify bonds for insurance and allow bidders to purchase the bonds with or without insurance. In a negotiated sale, the Authority will select a provider whose bid is most cost effective and whose terms and conditions governing the guarantee are satisfactory to the Authority.

B. Letters of Credit

The Authority may enter into a letter-of-credit (“LOC”) agreement when such an agreement is deemed prudent and advantageous. The Authority will prepare and distribute a RFP to qualified banks or other qualified financial institutions which includes terms and conditions that are acceptable to the Authority. The LOC will be awarded to the bank or financial institution providing the lowest cost bid with the highest credit quality that meets the criteria established by the Authority.

C. Liquidity

For variable rate debt requiring liquidity facilities to protect against remarketing risk, the Authority will evaluate:

- Alternative forms of liquidity, including direct pay letters of credit, standby letters of credit, and line of credit, in order to balance the protection offered against the economic costs associated with each alternative;
- Diversification among liquidity providers, thereby limiting exposure to any individual liquidity provider;
- All cost components attendant to the liquidity facility, including commitment fees, standby fees, draw fees, and interest rates charged against liquidity draws; and
- A comparative analysis and evaluation of the cost of external liquidity providers compared to the requirements for self-liquidity.

The winning bid will be awarded to the bank or financial institution providing the lowest cost with the highest credit quality that meets the criteria established by the Authority.

D. Use of Structured Products

No interest rate agreements or forward purchase agreements will be considered unless a policy defining the use of such products is approved before the transaction is considered.

Risk Assessment

The Office of State and Local Finance will evaluate each transaction to assess the types and amounts of risk associated with that transaction, considering all available means to mitigate those risks. The Office will evaluate all proposed transactions for consistency with the objectives and constraints defined in this Policy. The following risks should be assessed before issuing debt:

- A. **Change in Public/Private Use** – The change in the public/private use of a project that is funded by tax-exempt funds could potentially cause a bond issue to become taxable.
- B. **Default Risk** – The risk that debt service payments cannot be made by the due date.
- C. **Liquidity Risk** – The risk of having to pay a higher rate to the liquidity provider in the event of a failed remarketing.
- D. **Interest Rate Risk** – The risk that interest rates will rise, on a sustained basis, above levels that would have been set if the issued had been fixed.
- E. **Rollover Risk** – The risk of the inability to obtain a suitable liquidity facility at an acceptable price to replace a facility upon termination or expiration of a contract period.

Transparency

The Authority shall comply with the Tennessee Open Meetings Act, providing adequate public notice of meetings and specifying on the agenda when matters related to debt issuance will be considered. Additionally all costs (including interest, issuance, continuing, and one-time) shall be disclosed to the citizens in a timely manner (see also Federal Regulatory Compliance and Continuing Disclosure), including:

- A. Within four weeks of closing on a debt transaction, the debt service schedule outlining the rate of retirement of the principal amount shall be posted to the Authority's website;
- B. Within 45 days from closing, costs related to the issuance and other information, shall be prepared, a copy filed with the Office of State and Local Finance, and the original presented at the next meeting of the Authority; and
- C. Disclosure of costs will be made by electronic submission through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA") website.

Professional Services

The Authority 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 Authority. This includes "soft" costs or compensations in lieu of direct payments.

- A. **Issuer's Counsel** – The Authority will enter into an engagement letter agreement with each lawyer or law firm representing the Authority in a debt transaction. No engagement letter is required for any lawyer who is an employee of the Office of Attorney General and Reporter for the State of Tennessee who serves as counsel to the Authority or of the Office of General

Counsel, Office of the Comptroller of the Treasury, which serves as counsel to the Office of State and Local Finance regarding Authority matters.

B. Bond Counsel – Bond counsel is contracted by the Office of the Comptroller of the Treasury through the Office of State and Local Finance and serves to assist the Authority in all its limited special debt issues.

C. Financial Advisor – The financial advisor is contracted by the Office of the Comptroller of the Treasury through the Office of State and Local Finance and serves and assists the Authority on financial matters. The Authority shall approve the written agreement between the Office of the Comptroller of the Treasury and each person of the firm serving as financial advisor in debt management advisory services and debt issuance transactions. However, when in a competitive or negotiated sale, the financial advisor shall not be permitted to bid on, privately place or underwrite an issue for which they are or have been providing advisory services for the issuance. The Financial Advisor will be subject to a fiduciary duty which includes a duty of loyalty and a duty of care.

Potential Conflicts of Interest

Professionals involved in a debt transaction hired or compensated by the Authority shall be required to disclose to the Authority 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 and other issuers whom they may serve. This disclosure shall include that information reasonably sufficient to allow the Authority 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.

Debt Administration

A. Planning for Sale

1. Prior to submitting a bond resolution for approval, the Director of the Office of State and Local Finance (the “Director”), with the assistance of the financial advisor, will present to staff of the members of the Authority the purpose of the financing, the estimated amount of financing, the proposed structure of the financing, the proposed method of sale for the financing, members of the proposed financing team, and an estimate of all the costs associated with the financing, and/or;
2. In the case of a proposed refunding, proposed use of credit enhancement, or proposed use of variable rate debt, the Director will present the rationale for using the proposed debt structure, an estimate of the expected savings associated with the transaction and a discussion of the potential risks associated with the proposed structure.
3. The Director, the Bond Accountant, bond counsel, financial advisor, along with other members of the financing team will prepare a Preliminary Official Statement describing the transaction and the security for the debt that is fully compliant with all legal requirements.

B. Post Sale

1. The Director will present a post-sale report to the members of the Authority describing the transaction and setting forth all the costs associated with the transaction.
2. The financial advisor will provide a closing memorandum with written instructions on transfer and flow of funds.
3. The Director 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.
4. The Director, the Bond Accountant, bond counsel, financial advisor, along with other members of the financing team will prepare an Official Statement describing the transaction and the security for the debt that is fully compliant with all legal requirements.

Federal Regulatory Compliance and Continuing Disclosure

A. Arbitrage

The Office of State and Local Finance will comply with arbitrage requirements on invested tax-exempt bond funds. 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 Authority will comply with all of its tax certificates for tax-exempt financings by monitoring the arbitrage earnings on bond proceeds on an interim basis and by rebating all positive arbitrage when due, pursuant to Internal Revenue Code, Section 148. The Authority currently contracts with an arbitrage consultant to prepare these calculations, when needed. The Authority 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.

B. Investment of Proceeds

Any proceeds or other funds available will be deposited with the State Treasurer or a Trustee for investment. The proceeds must be invested pursuant to the state policy found in Section 9-1-118, Tennessee Code Annotated, and the State of Tennessee Statement of Investment Policy.

C. Disclosure

In complying with U.S. Securities and Exchange Commission Rule 15c2-12, the Authority will provide to EMMA certain financial information and operating data no later than January 31, of each year, and will provide notice of certain enumerated events with respect to the bonds, if material. Such material events include:

1. Principal and interest payment delinquencies
2. Nonpayment-related defaults
3. Unscheduled draws on credit enhancements

4. Substitution of credit or liquidity providers or the failure of performance on the part of a liquidity provider
5. Adverse tax opinions or events affecting the tax-exempt status of any bonds
6. Modifications to rights of bond holders
7. Bond calls
8. Defeasances
9. Matters affecting collateral
10. Rating changes

D. Generally Accepted Accounting Principles (GAAP)

The Authority will comply with the standard accounting practices adopted by the Financial Accounting Standards Board and the Governmental Accounting Standards Board when applicable.

Review of the Policy

The debt policy guidelines outlined herein are only intended to provide general direction regarding the future use and execution of debt. The Authority 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 Authority's goals.

This policy will be reviewed by the Authority no less frequently than annually. At that time, the Director will present any recommendations for any amendments, deletions, additions, improvement or clarification.

Adoption of the Policy

1. A public hearing on the Policy was held on the following date:.
2. The Authority adopted this Policy on _____ 2011, effective _____, 2011.

Vice Chair
Tennessee Local Development Authority