

THIS PRINT COVERS CALENDAR ITEM NO. : 12

**SAN FRANCISCO
MUNICIPAL TRANSPORTATION AGENCY**

DIVISION: Finance and Information Technology

BRIEF DESCRIPTION:

Approving a debt policy for the San Francisco Municipal Transportation Agency.

SUMMARY:

- A formal debt policy is adopted by most governmental agencies as a best practice and most public issuers in the region and in San Francisco have adopted formal debt policies.
- The proposed debt policy clearly sets forth the guidelines and restrictions that will direct the SFMTA as it prepares to enter the capital markets in the coming years to issue debt to fund capital projects.
- The purpose of a debt policy is to organize and formalize debt issuance-related policies and procedures for the SFMTA in a single guiding document; the debt policy establishes, in a public manner for the financial markets, the SFMTA's desire to adhere to sound debt management practices and to ensure its debt policies are consistent with the relevant local, state and Federal laws.
- The SFMTA's overall goal, as detailed in the debt policy, is to use debt appropriately and achieve the lowest cost of borrowing while preserving financial flexibility and maintaining strong credit ratings.

ENCLOSURES:

1. SFMTAB Resolution
2. Proposed Debt Policy

APPROVALS:

DIRECTOR OF DIVISION
PREPARING ITEM

DATE

FINANCE

DIRECTOR

SECRETARY

ADOPTED RESOLUTION Sonali Bose
BE RETURNED TO

ASSIGNED SFMTAB CALENDAR DATE: _____

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PURPOSE

This calendar item approves a debt policy for the SFMTA.

GOAL

This item will meet the following goal and objectives of the SFMTA Strategic Plan:

- Goal 4, Financial Capacity: To ensure financial stability and effective resource utilization.

DESCRIPTION

The proposed debt policy (Enclosure 2) was first presented to the Board in draft form at the February 15, 2011 workshop. SFMTA then provided a response to questions from Board members in a memorandum dated March 7, 2011.

Summary

A formal debt policy is adopted by most governmental agencies as best practices. The Government Finance Officers Association (GFOA) and the California Debt and Investment Advisory Commission (CDIAC) strongly recommend that public governing boards, such as the SFMTA Board, adopt a debt policy. Most public issuers in the region and the City have an adopted debt policy including the City and County of San Francisco, San Francisco Airport, San Francisco Public Utilities Commission, Port of San Francisco as well as the San Francisco Bay Area Rapid Transit District (BART), Santa Clara Valley Transportation Authority (VTA) and AC Transit.

The debt policy sets forth the guidelines and restrictions that will direct the SFMTA as it prepares to enter the capital markets in the coming years to issue debt to fund capital projects. The debt policy describes the process for Board approval for bond issuances and establishes the broad framework of borrowing options available to the SFMTA, as well as specific financial criteria and debt metrics that the SFMTA must meet and monitor before it can undertake and implement any future debt issuance. These criteria and metrics are designed to ensure that the SFMTA pursues prudent borrowing practices. In this respect, the adoption of the debt policy is a critical cornerstone to (i) establish the SFMTA as a financially strong and well managed entity, (ii) achieve the highest practical ratings thus making the bonds attractive to potential borrowers and (iii) thereby achieve the lowest borrowing costs for the SFMTA.

Background

The SFMTA has the authority to issue its own debt without further voter approval through the Charter of the City and County of San Francisco. Upon recommendation from the SFMTA's Board, the Board of Supervisors may authorize the SFMTA to incur debt provided that: 1) the

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Controller first certifies that sufficient unencumbered balances are expected to be available in the proper fund to meet all payments under such obligations as they become due; and 2) any debt obligation is secured by revenues under the jurisdiction of the SFMTA.

Before issuance of any debt, the SFMTA shall have received final approval from the SFMTA Board for the specific documents and other legal promises that will govern the debt issuance. As part of this process, the SFMTA Board shall receive briefings and presentations from its legal and financial team, including an external bond counsel and the SFMTA's internal counsel, to ensure that the SFMTA Board understands the capital improvements to be financed and the structure of the proposed indebtedness. In addition, the SFMTA Board shall review and approve any disclosure document prepared in connection with a proposed transaction.

The SFMTA may issue debt directly, as the issuing agency, or through another entity, such as the San Francisco Municipal Railway Improvement Corporation (SFMRIC). In either case, the SFMTA will adhere to this debt policy when SFMTA revenues or assets secure the repayment of the debt. As stated in the debt policy, the SFMTA will ensure that any debt issuance is consistent with other internal SFMTA planning documents, such as the Five-Year Capital Investment Plan (CIP) and the Capital Budget, before seeking the SFMTA Board's approval.

An important feature of the proposed debt policy is the creation and maintenance of reserve or stabilization accounts to protect against revenue shortfalls and unpredicted one-time expenses and to ensure that adequate funds are available to repay the debt under extenuating circumstances. The maintenance of prudent reserves is also an essential component of the SFMTA's ongoing efforts to maintain good relations with rating agencies and investors by following financial best practices. The debt policy outlines two separate reserve accounts for the SFMTA: 1) "Rainy Day" / Contingency Reserve equal to 10 percent of operating costs (this reserve was previously approved and established by the SFMTA Board in 2007); and 2) Operational Debt Reserve equal to three years of annual SFMTA debt service. The debt policy states that it is the goal of the SFMTA to maintain these reserves at the targeted levels. However, the debt policy also states that the SFMTA's ability to fully fund its reserves is dependent on future financial forecasts and its ability to cover all operations and debt service obligations before adequately funding the required reserves. In other words, goals and targets are established, but flexibility is provided.

The remainder of the proposed debt policy provides specific guidelines relating to the SFMTA's goals and objectives in a debt issuance, types of debt that the SFMTA may issue, required terms for any debt issuance, policies for selecting outside professionals to assist in debt issuance, as well as general guidelines and debt metrics that the SFMTA must satisfy prior to any borrowing. Generally, it is the preference of the SFMTA to issue long-term, fixed rate debt whenever appropriate. However, the debt policy recognizes that market conditions and specific project requirements may require the evaluation and use of alternative structures and provides the flexibility as needed.

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The SFMTA's overall goal is to use debt appropriately and achieve the lowest cost of borrowing while preserving financial flexibility and maintaining strong credit ratings. Consistent with these goals, the debt policy states that the SFMTA will seek to maintain annual debt service payments to a level not to exceed 5% of the SFMTA's annual total operating expenses.

Purpose of a Debt Policy

The purpose of a debt policy is to organize and formalize debt issuance-related policies and procedures for the SFMTA in a single guiding document. The debt policy establishes, in a public manner for the financial markets, the SFMTA's desire to adhere to sound debt management practices and to ensure its debt policies are consistent with the relevant local, state and Federal laws.

Formulation of the Debt Policy

As part of the process in drafting a debt policy appropriate for the SFMTA, the following steps were taken:

- Reviewed debt policy guidelines provided by the GFOA and the CDIAC; these materials helped to define the appropriate items to cover in the SFMTA's policy
- Reviewed adopted debt policies currently in use by other major Bay Area transportation agencies (such as AC Transit, San Francisco International Airport and the Port of San Francisco) and general issuers (such as the City and County of San Francisco and the City of Oakland)
- Incorporated the SFMTA's specific characteristics including the following:
 - SFMTA will be a new issuer
 - SFMTA's fund balance levels
 - SFMTA's financial structure

A debt policy is a living document that will be updated to reflect changes in the SFMTA's financial situation as well as the capital markets as necessary.

Major Sections of the Debt Policy

Provided below is an overview of the debt policy's major sections and the policy goals that they seek to accomplish:

I. INTRODUCTION

This section states the purpose of the debt policy.

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II. DEBT POLICY OBJECTIVES

This section outlines the SFMTA's objectives in any debt financing and the purpose for debt financing in the first place; mainly accelerating capital projects.

III. SCOPE OF POLICY

This section defines what the debt policy pertains to (issuance of new debt obligation and management of existing obligations) and how the SFMTA will implement and maintain the debt policy.

IV. LEGAL AUTHORITY

This section defines how the SFMTA has the authority to issue debt and also the entities through which the SFMTA may issue debt, which include both SFMRIC and the SFMTA itself.

V. CAPITAL PLANNING AND BUDGETING

This section describes how the SFMTA's capital planning and budgeting process, including key documents such as the Capital Budget and Five-Year CIP, inform its debt policy and debt management. The SFMTA's goal will be to issue and manage debt in a manner that is consistent with its approved capital plans and budget. This section also spells out the SFMTA's policy goal of maintaining adequate reserves (Contingency Reserve and Operational Debt Reserve) both to help make debt payments if necessary and to strengthen its credit ratings.

VI. PURPOSES OF BONDS

This section defines what debt obligations will be issued for; mainly to fund capital projects (New Money) or to refinance prior obligations that initially financed capital projects (Refunding).

VII. TYPES OF DEBT

This section defines the different types of debt (long-term, short-term, variable rate, lease financing) that the SFMTA can contemplate issuing, as well as specific instruments that are associated with these types of debt.

VIII. TERMS AND CONDITIONS OF BONDS

This section defines the baseline terms and conditions that must be a part of SFMTA debt issuance as well SFMTA-wide debt management metrics that must be monitored prior to every issuance. Parameters covered in this section include term, structure, call provisions, debt service reserve funds and others.

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IX. THIRD PARTY CREDIT ENHANCEMENT

This section defines when credit enhancement may be secured to enhance the efficiency of specific SFMTA debt issuances. This section also describes the type of credit enhancement facilities that the SFMTA is likely to use in connection with its debt issuances.

X. REFINANCING OUTSTANDING DEBT

This section describes the conditions under which the SFMTA will seek to refinance its outstanding debt and provides guidelines for how to undertake a refinancing.

XI. METHODS OF ISSUANCE

This section describes the SFMTA's available methods to issue debt (competitive sale, negotiated sale and private placement) and elaborates on the conditions under which each method is appropriate.

XII. MARKET RELATIONSHIPS

This section defines the SFMTA's goals in maintaining relationships with key financial market participants; primarily the rating agencies and the SFMTA's potential bond investors. This section also describes the SFMTA's Federal tax Llw ongoing disclosure requirements whose prompt filing will also help to facilitate transparency and good relationships with market participants.

XIII. PROFESSIONALS

This section describes the team of financing professionals that the SFMTA will need to assemble when undertaking a debt financing and provides guidelines for selecting those professionals.

ALTERNATIVES CONSIDERED

The alternative to approving this resolution is to continue without a debt policy to guide the issuance of one or more bond financings.

FUNDING IMPACT

None with this policy adoption. However, there will be funding impacts if bonds are issued with approval by the SFMTA Board and the Board of Supervisors.

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OTHER APPROVALS RECEIVED OR STILL REQUIRED

None. SFMTA Board and Board of Supervisors approval (and SFMRIC Board approval in the case of debt issued through SFMRIC) will be required for the actual bond financings.

The City Attorney's Office has reviewed this calendar item.

RECOMMENDATION

Staff recommends that the SFMTA Board of Directors approve the attached debt policy.

SAN FRANCISCO
MUNICIPAL TRANSPORTATION AGENCY
BOARD OF DIRECTORS

RESOLUTION No. _____

WHEREAS, The adoption of a formal debt policy is recommended as a best practice by the Government Finance Officers Association and the California Debt Advisory and Investment Commission, and most public issuers in the region and in San Francisco adopted formal debt policies; and,

WHEREAS, The proposed debt policy sets forth the guidelines and restrictions that will direct the SFMTA as it prepares to access the capital markets in the coming years to issue debt to fund capital projects; and,

WHEREAS, The purpose of a debt policy is to organize and formalize debt issuance-related policies and procedures for the SFMTA in a single guiding document; the debt policy establishes, in a public manner for the financial markets, the SFMTA's desire to adhere to sound debt management practices and to ensure its debt policies are consistent with the relevant local, state and Federal laws; and,

WHEREAS, The SFMTA's overall goal, as detailed in the debt policy, is to use debt appropriately and achieve the lowest cost of borrowing while preserving financial flexibility and maintaining strong credit ratings; now, therefore, be it

RESOLVED, That the Municipal Transportation Agency Board of Directors approves a debt policy that sets forth the guidelines and restrictions that will direct the SFMTA as it prepares to enter the capital markets in the coming years to issue debt to fund capital projects.

I certify that the foregoing resolution was adopted by the San Francisco Municipal Transportation Agency Board of Directors at its meeting of _____.

Secretary to the Board of Directors
San Francisco Municipal Transportation Agency

SAN FRANCISCO MUNICIPAL TRANSPORTATION AGENCY DEBT POLICY

INTRODUCTION

The purpose of this Debt Policy (the “Policy”) is to organize and formalize debt issuance-related policies and procedures for the San Francisco Municipal Transportation Agency (“SFMTA” or the “Agency”). This Debt Policy confirms the commitment of the Agency’s Board of Directors (“Board”), management and staff to adhere to sound debt management practices. The debt policies and procedures of the Agency are subject to and limited by the applicable provisions of State and Federal law.

DEBT POLICY OBJECTIVES

The primary objectives of the Agency’s debt and financing related activities are to:

- Assure the timely delivery of, and finance capital projects in accordance with the priorities identified within the Charter of the City and County of San Francisco, under the direction of the Board of Directors
- Achieve the lowest cost of borrowing while identifying mitigation factors for any additional risk to the Agency
- Preserve future financial flexibility
- Maintain strong credit ratings and good investor relations

SCOPE OF POLICY

This Debt Policy shall govern the issuance and management of all bonds, notes, certificates, lease financings and other obligations for borrowed money together with the credit, liquidity and other instruments and agreements secured or executed in connection with such obligations.

While adherence to this Policy is required in applicable circumstances, the Agency recognizes that changes in the capital markets, Agency programs and other unforeseen circumstances may from time to time create situations that are not covered by the Policy and will require modifications or exceptions to achieve policy goals. In these cases, management flexibility is appropriate, provided specific authorization from the Board is obtained.

This Policy will be reviewed annually and updated as needed, with any proposed changes to be considered and approved by the Board. Responsibility for administration of this Policy shall lie with the Board. Responsibility for implementation of the Policy, and day-to-day responsibility and authority for structuring, implementing, and managing the Agency’s debt and finance program, shall lie with the Chief Financial Officer. This Debt Policy requires that the Board specifically authorize each debt financing and its related documents or agreements.

LEGAL AUTHORITY

Under the Charter of the City and County of San Francisco, the Agency has, to the maximum extent permitted by law, with the concurrence of the Board of Supervisors, and notwithstanding the requirements and limitations of Sections 9.107, 9.108, and 9.109, the authority without further voter approval to incur debt for Agency purposes and to issue or cause to be issued bonds, notes, certificates of indebtedness, commercial paper, financing leases, certificates of participation or any other debt instruments. Upon recommendation from the Board of Directors, the Board of Supervisors may authorize the Agency to incur on behalf of the City such debt or other obligations provided: 1) the Controller first certifies that sufficient unencumbered balances are expected to be available in the proper fund to meet all payments under such obligations as they become due; and 2) any debt obligation, if secured, is secured by revenues or assets under the jurisdiction of the Agency.

The Agency may also from time-to-time issue debt through other entities under its legal authority, such as the San Francisco Municipal Railway Improvement Corporation (SFMRIC), as appropriate. In these instances the proposed debt issuance will be evaluated and approved as if it were a direct issuance of the Agency if the proposed obligation will be repaid from Agency revenues and all provisions of this policy will apply to those obligations (this debt will also be included in calculations of “Agency-wide” debt).

All bonds of the Agency shall be issued in accordance with applicable provisions of the Charter and federal and state laws, rules and regulations, including the Internal Revenue Code of 1986 (the “Code”), the Securities Act of 1934 and the Securities Exchange Act of 1933, in each case as supplemented and amended, and regulations promulgated pursuant to such laws.

CAPITAL PLANNING AND BUDGETING

The Agency’s borrowing decisions in terms of timing, amount, structure and alternative products will be made in the context of the Agency’s 5-year Capital Investment Plan (CIP) and the Agency’s Capital Budget. As the Agency’s CIP is developed in the context of the Agency’s Strategic Plan and Long Range Transit Plan, borrowing decisions will be made in the appropriate strategic context to ensure that any proposed borrowing is directly supporting the goals and objectives of the Agency. While the 5-year CIP represents the unconstrained (i.e., unconstrained by available revenues) plan for the Agency, the Capital Budget expenditures are constrained based upon the amount of realistic revenues resulting in balanced budgets for all fiscal years to which they apply. Developing financing strategies in this context ensures that any proposed borrowing both supports the long-term goals of the Agency and its affordability from a budgetary perspective.

5-Year Capital Investment Plan

The Agency’s 5-Year CIP focuses on integrating capital planning, capital budgeting, capital financing and capital project prioritization concepts into a long-range strategic plan designed to improve the capital assets of the SFMTA. The major objectives of this program are to

strategically invest the Agency's dollars into capital assets, thereby improving their physical condition, extending their useful life and increasing their value as well as acquiring new assets. Investing in the capital program will strengthen the SFMTA's ability to achieve many of its strategic goals, such as delivering better quality services and increasing the financial capacity of the Agency.

The CIP provides information on the development of capital projects, types of construction programs, capital funding, capital prioritization process, capital implementation process and the capital asset management/inventory process. The CIP also provides a listing of capital projects that represent the most critical capital investment needs of the SFMTA.

Capital Budgets

While the CIP reflects a five-year projection of capital needs, the capital budgets are developed based upon a variety of budget assumptions. The planned expenditure assumptions are based upon the phase of the project, project needs and impacts on the potential workload of the project management staff. The anticipated revenues are based upon assumptions driven by the various Federal, State, and Local agencies that provide funding for Agency capital projects.

The Board's adoption of the 5-year CIP or Capital Budget does not, in and of itself, constitute authorization for debt issuance for any capital projects. Each financing shall be presented to the Board for separate approval.

Maintenance of Adequate Reserves

The Agency shall maintain unencumbered reserve amounts sufficient in the determination of the Agency to cover unexpected revenue losses, operating and maintenance costs, extraordinary payments, and other contingencies, and to provide liquidity in connection with the Agency's outstanding debt. The Agency recognizes that maintenance of adequate reserves is not only a commonly accepted financial best practice for transit agencies, but also a critical component of the Agency's credit relations with market participants designed to minimize the Agency's overall cost of borrowing. The Agency's ability to fully fund its reserves will be dependent on future financial forecasts and its ability to cover all operations and debt service obligations, before adequately funding the required reserves.

Specifically the Agency will maintain the following reserves

- 1) *"Rainy Day"/Contingency Reserve.* The Agency shall maintain an unencumbered Contingency ("Rainy Day") Reserve to cover unexpected revenue losses, operating and maintenance costs, extraordinary payments, and other contingencies consistent with the Agency's Official Reserve Policy, approved in 2007. The Agency's Reserve Policy establishes a goal of setting aside a Rainy Day reserve at 10% of each year's operating costs and states that the Agency intends to gradually ramp up to its desired reserve target over a ten year period.

2) *Operational Debt Reserve*. Once the Agency begins undertaking a long-term borrowing program, the Agency shall maintain a separate unencumbered Operational Debt Reserve with a goal of setting aside 3 years of the Agency's annual debt service. The Operational Debt Reserve is available, but not limited, to debt service payments and may be used for other purposes. With the establishment of the Operational Debt Reserve and the funding target, the Board acknowledges the increased importance of liquid resources as a critical component to the Agency's fiscal health and credit strength as it enters into long-term obligations with bond holders and other lenders.

PURPOSES OF BONDS

The Agency may issue debt obligations for the purposes of financing and refinancing the costs of capital projects undertaken by the Agency. Long-term debt financing shall not be used to fund operating costs.

A debt transaction will be categorized as a new money financing or a refunding financing according to the following criteria.

New Money Financing

New money issues are financings that generate new proceeds for capital projects. Eligible capital projects include the acquisition, construction or major rehabilitation of capital assets as well as the acquisition of capital equipment such as transit vehicles. Projects that provide new or increased revenue sources to the Agency upon their completion shall be considered a top candidate for debt financing. New money debt proceeds may not be used for operating expenses. If the Agency is issuing debt to reimburse itself for a recent capital project, within Federal limits, or issuing debt used to repay an interim financing vehicle such as commercial paper that itself funded a new capital project, that debt will also be considered new money in line with Federal regulations.

Refunding Financing

Refunding bonds are issued to retire all or a portion of an outstanding bond issue. Refunding issuances can be used to achieve present-value savings on debt service or to restructure the payment schedule, type of debt instrument used or covenants of existing debt. The Agency must analyze the refunding issue on a present-value basis to identify economic effects before approval. Policies on the administration of refunding financings are detailed further in Section X. Refinancing Outstanding Debt.

TYPES OF DEBT

When the Agency determines that the use of debt is appropriate, the following criteria will be utilized to evaluate the type of debt to be issued. The Agency shall consider risks associated with each type of debt and the potential impact on the Agency's finances. It is the preference of the Agency to issue long-term fixed rate debt whenever appropriate; however this policy also

recognizes that market conditions and specific project requirements may require the evaluation and eventual implementation of alternative structures.

Consistent with its credit rating objectives, the Agency shall periodically review its debt affordability levels and capacity for the undertaking of new financing obligations to fund its capital improvement plans. Debt affordability measures shall be based upon the credit objectives of the Agency, criteria identified by rating agencies for high-grade credits, comparison of industry peers and other internal factors of the Agency. A summary review of selected major transit agencies and their rating profile may provide a peer comparative basis. While there are many unique characteristics to each of these entities, the nature of their applicable pledged revenues, lien structures, other covenants and policies will provide a limited snapshot to aid in evaluating relative debt capacity and high grade rating considerations and tradeoffs.

Long-Term Debt

The Agency may issue long-term debt (i.e., debt with a final maturity of at least 5 years) when projects cannot be funded from resources on hand. The proceeds derived from long-term borrowing will not be used to finance current operations or maintenance.

- 1) *Current Coupon Bonds* are bonds that pay interest periodically and principal at maturity. They may be used for both new money and refunding transactions. Bond features should be adjusted to accommodate the market conditions at the time of sale, including changing dollar amounts for principal maturities, offering discount and premium bond pricing, modifying call provisions, utilizing bond insurance and determining how to fund the debt service reserve fund.
- 2) *Zero Coupon and Capital Appreciation Bonds* pay interest only when principal matures. Interest continues to accrue on the unpaid interest, therefore representing a more expensive funding option. In the case of zero-coupon bonds, principal and interest, at one coupon rate, is repaid at maturity. In the case of Capital Appreciation Bonds, the value of the bond accretes until maturity
- 3) *Transportation Infrastructure Finance Innovation Act (TIFIA) Loan* is a loan provided by the United States Department of Transportation for transportation projects of regional importance. The Agency may elect to apply for a TIFIA loan if it is determined that it is the most cost effective debt financing option available. TIFIA loans may be used in conjunction with other forms of long-term debt.
- 4) *Grant Anticipation Revenue Vehicle Financing (GARVEE)* are debt obligations secured by certain federal grants such as Federal Transit Administration (FTA) section 5307 funds or a Full Funding Grant Agreement under the Section 5309 New Starts Program. The Agency may consider the issuance of GARVEEs as an alternative to traditional revenue bonds.

Short-Term Debt

The Agency may issue debt with shorter-term maturities, including commercial paper and grant and bond anticipation notes, to provide interim financing for capital projects in anticipation of the issuance of long-term debt and/or the receipt of Grant moneys. The Agency may use commercial paper, a line of credit or a similar short-term product as a source of temporary funding of operational cash flow deficits where anticipated revenues are defined as an assured revenue source with the anticipated amount based on conservative estimates. Short-term borrowings to support operations may not be refinanced with long-term debt and must be repaid with eligible revenue sources, as available. Short-term obligations shall consist of obligations with a final maturity of less than 5 years.

- 1) *Commercial Paper Notes* may be issued as an alternative to fixed rate debt, particularly when the timing of funding requirements and project costs are uncertain. The Agency may maintain an ongoing commercial paper program to ensure flexibility and immediate access to capital funding when needed. The retirement of commercial paper is most commonly a result of the issuance of long-term bonds. Periodic issuances or retirements of commercial paper notes with a Board approved commercial paper program do not require further Board action.
- 2) *Grant Anticipation Notes (GANs)* are short-term notes that are repaid with the proceeds of State or Federal grants of any type.
- 3) *Bond Anticipation Notes (BANs)* are short-term notes that are repaid with the proceeds of a long-term bond issuance. The Agency may wish to consider BANs as an interim financing strategy to accelerate projects ahead of an upcoming bond transaction. Short-term, fixed interest rates will be considered under a proposed BAN strategy, as will the interest rate risk associated with the proposed long-term take-out of the BANs.
- 4) *Direct Line of Credit* shall be considered as an alternative to other short-term borrowing options. They are often structured as a short-term agreement with a financial institution providing the line of credit. The line of credit shall be structured to limit concerns as to the Internal Revenue Code.

Variable Rate Debt

To maintain a predictable debt service burden, the Agency will give preference to debt that carries a fixed interest rate. An alternative to the use of fixed rate debt is floating or variable rate debt. It may be appropriate to issue variable rate debt to diversify the Agency debt portfolio, reduce interest costs, provide interim funding for capital projects and improve the match of assets to liabilities. Variable rate debt typically has a lower cost of borrowing than fixed rate financing, but carries interest rate risk as the interest rates on the bonds are periodically reset on a daily or weekly basis. The amount of long-term variable rate debt will not exceed 20% of all outstanding debt. The Agency will incorporate its variable rate debt into its ongoing budget

process by using an interest rate assumption which provides an adequate cushion for market fluctuations when estimating the debt service requirements for variable rate debt.

The Agency may issue bonds that may be converted between two or more interest rate modes without the necessity of a refunding. Such interest rate modes may include, without limitation, daily interest rates, weekly interest rates, other periodically variable interest rates, fixed rates for a term and fixed rates to maturity.

The cost and availability of third-party liquidity to support variable rate debt will be considered when evaluating the use of variable rate obligations. The current cost, ongoing liquidity renewal risk and other risks will be described and presented to the Board when variable rate debt is presented as an alternative.

Lease Financing Structures

Lease obligations are a routine and appropriate means of financing capital equipment. These types of obligations should be considered where lease financing will be more beneficial, either economically or from a policy perspective. A tax-exempt lease may be used to finance any property that the Agency has the statutory authorization to lease. As a general matter, only land and depreciable property may be leased. Generally, the leased property is a capital asset to be used by the Agency in its own operations, however a tax-exempt lease financing can be used to provide a facility for the use of another borrower or when the Federal Government has partial ownership of the project through the inclusion of Federal grants in the funding plan.

Payments made by the Agency pursuant to a long-term lease may be made from any lawfully available funds of the Agency. The useful life of the capital equipment, the terms and conditions of the lease, the direct impact on debt capacity and budget flexibility will be evaluated prior to the implementation of a lease program. All leases providing tax-exempt financing are subject to this policy, as are all leases, master leases and leasing programs having a cumulative value exceeding \$10 million.

This Policy covers the following Lease Financing structures commonly used by transit agencies:

- 5) **CERTIFICATES OF PARTICIPATION (COPs):** In the event the Agency wishes to utilize a tax-exempt lease in connection with the sale of municipal securities, certificates of participation, representing undivided interests in the rental payments under the tax-exempt lease, may be sold to the public.

- 6) **LEASE REVENUE BONDS:** Bonds issued by another public entity (such as a SMFRIC or the Parking Authority) or on behalf of the Agency to provide a means to finance capital improvements to be leased to the Agency. The bonds are payable solely from lease payments paid by the Agency to the original entity.

- 7) CAPITAL/EQUIPMENT LEASE: The Agency may also use long-term lease obligations to directly finance or refinance specific capital equipment.

Revenue Bond Structures

The Agency may issue bonds that are payable in whole or in part from a stream of revenues of the Agency (Revenue Bonds). No Revenue Bonds shall be issued by the Agency unless an outside counsel has certified that the pledge revenue in question is part of a valid, self-sufficient enterprise fund and can be appropriately pledged by the Agency. No Revenue Bonds shall be issued by the Agency without compliance with the applicable provisions of this debt policy such as a well-defined additional bonds test. Neither the credit nor the taxing power of the City, the State of California or any political subdivision of the State other than the Agency shall be pledged or available to pay or secure the Revenue Bonds of the Agency.

Financial Derivative Products.

The Agency will consider the use of derivative products only in instances where it has been demonstrated that the derivative product will either provide a hedge that reduces risk of fluctuations in expense or revenue, or alternatively, where it will reduce the total project cost. At this time the Agency does not anticipate using any derivative products in any future financing plans and therefore has purposely not addressed them further in this policy. If at some point in the future the Agency wishes to reconsider the use of derivative products in connection with future debt issuances in order to create a qualified hedge it will first draft and submit a separate policy to address the use of derivative products to the Board. Derivative products will only be utilized with prior approval from the Board.

TERMS AND CONDITIONS OF BONDS

The Agency shall establish all terms and conditions relating to the issuance of bonds, and will control, manage and invest all bond proceeds. Unless otherwise authorized by the Agency, the following shall serve as bond requirements:

General Guidelines for all Agency Borrowings

Unless changed by Board action, it is the policy of the Agency to meet the targets listed below. These limits, in combination with the Agency's updated Capital Budget and 5-Year CIP which are, in turn, guided by the Agency's Strategic Plan and Long Range Transit Plan. By following the guidelines established in these planning documents the Agency will ensure that it continues to provide essential operational services while planning for replacement, rehabilitation, repair and expansion of its capital investments.

- 1) The Agency will seek to maintain aggregate annual debt service on long-term debt, including lease obligations, at a level not-to-exceed 5% of the Agency's

annual total operating expenses. The actual terms and conditions specific to each debt issue will be controlled by the applicable documents.

- 2) So long as the above conditions are met, the Agency will seek to minimize the level of debt outstanding consistent with the most recent Capital Budget and 5-Year CIP.

Term

All capital improvements financed through the issuance of debt will be financed for a period not to exceed the 120% of the average useful life of the assets being financed.

Additional Bonds Test.

To the extent the Agency is issuing Revenue Bonds as contemplated by this policy, the associated documents must contain a well formulated Additional Bonds Test which limits the issuance of additional debt secured by the Pledged Revenues. While the specific formulation of the Additional Bonds Test may vary depending on the type of Revenue Bonds being contemplated, the Agency will utilize an Additional Bonds which establishes a limitation on new issuances such that the Pledged Revenues are no less than one and a half times (1.5x) the maximum annual principal and interest and debt service for the aggregate outstanding senior lien Revenue Bonds including the debt service for the new issuance.

Lien Levels

Senior and Junior Liens for the Agency's borrowing program may be utilized in a manner that will allow for the most beneficial use of the revenue source(s) securing the borrowing.

Debt Service Structure

The Agency's debt service structure will be developed and maintained to achieve strong credit ratings while addressing the overall revenue constraints and capacity of the Agency. The Agency will first consider a level debt service structure, in aggregate for all outstanding bond issuances, when evaluating proposed borrowing strategies. In the case of assets with shorter useful lives and the expectation of near-term revenues, the Agency may wish to accelerate the repayment of a specific borrowing to reduce interest costs. The Agency shall maintain the flexibility to consider deferred repayment structures if appropriate.

Call Provisions

The Agency shall seek to include the optional call rights on bonds with a final maturity of more than 10 years, consistent with optimal pricing of such bonds. Call premiums, if any, should be consistent with then prevailing market standards so as to produce the most advantageous borrowing cost for the Agency.

Debt Service Reserve Funds

The Agency may be required to issue bonds that are secured, in part, by amounts on deposit in or credited to a debt service reserve fund or account in order to minimize the net cost of borrowing and/or to provide additional reserves for debt service or other purposes. Debt service reserve funds may secure one or more series of bonds, and may be funded by proceeds of bonds, other available moneys of the Agency, and/or by suitable surety policies, letters or lines of credit or other similar instruments. Appropriately rated surety policies, letters or lines of credit or other similar instruments may be substituted for amounts on deposit in a debt service reserve fund if such amounts are needed for capital projects or other purposes.

Capitalized Interest Accounts

The Agency may choose to establish a Capitalized Interest Account in connection with a specific bond issuance whose proceeds shall be used for the payment of interest related to the bonds for a period of time. Capitalized Interest Accounts are most commonly used when a bond financed project generates revenue that is the primary source of repayment for the bonds or, in the case of lease financings, during the construction period of the project being financed. In the event that project revenues will not be available until a period of time after project construction is completed, a Capitalized Interest Account may serve as the alternative source of funds used to pay interest to bondholders. Generally, a Capitalized Interest Account for a specific bond issuance may be funded through substantial project completion plus a period of no more than 18 months. In any event, when issuing Tax-Exempt Bonds the Agency will adhere to all relevant IRS regulations pertaining to limitations on the funding of Capitalized Interest Accounts.

THIRD PARTY CREDIT ENHANCEMENT

The Agency may secure credit enhancement for its debt from third-party credit providers to the extent such credit enhancement is available upon reasonable, competitive and cost-effective terms. Such credit enhancement may include municipal bond insurance ("Bond Insurance"), letters of credit and lines of credit (collectively and individually, "Credit Facilities"), as well as other similar instruments. The Agency will also evaluate its ability to address contingency risk associated with credit enhancement providers (e.g. downgrade of such providers). Credit enhancement providers shall be selected on a competitive or negotiated basis dependent upon procurement requirements and market constraints.

Bond Insurance

All or any portion of an issue of bonds may be secured by Bond Insurance provided by municipal bond insurers ("Bond Insurers") if it is economically advantageous to do so, or if it is otherwise deemed necessary or desirable in connection with a particular issue of Bonds. The relative cost or benefit of Bond Insurance may be determined by comparing the amount of the

Bond Insurance premium to the present value of the estimated interest savings to be derived as a result of the insurance.

Credit Facilities

The issuance of certain types of bonds requires a letter of credit or line of credit (a "Credit Facility") from a commercial bank or other qualified financial institution to provide liquidity and/or credit support. The types of bonds where a Credit Facility may be necessary include commercial paper and variable rate bonds.

The criteria for selection of a Credit Facility provider shall include the following:

- 1) Long-term ratings from at least two nationally recognized credit rating agencies ("Rating Agencies") that have, at the time of selection, no rating below A2/A/A.
- 2) Short-term ratings from at least two Rating Agencies of at least P-1/A-1 or equivalent;
- 3) Experience providing such facilities to state and local government issuers;
- 4) Fees, including initial and ongoing costs of the Credit Facility; draw, transfer and related fees; counsel fees; termination fees and any trading differential; and
- 5) Willingness to agree to the terms and conditions proposed or required by the Agency.

REFINANCING OUTSTANDING DEBT

The Agency shall have the responsibility to analyze outstanding bond issues for refunding opportunities that may be presented by underwriting and/or financial advisory firms. The Agency will consider the following issues when analyzing possible refunding opportunities:

Debt Service Savings

The Agency has established a minimum net present value (NPV) debt service savings threshold goal of three (3) percent of the refunded bond principal amount unless there are other compelling reasons for defeasance. The present value savings will be net of all costs related to the refinancing.

Restructuring

The Agency may restructure outstanding debt to meet unanticipated revenue expectations, mitigate irregular debt service payments, release reserve funds or amend restrictive bond covenants.

Term of Refunding Issues

The Agency may refund bonds within the term of the originally issued debt. However, the Agency may consider maturity extension, when necessary to achieve a desired outcome, provided that such extension is legally permissible and potential credit impacts are adequately

evaluated. The remaining useful life of the financed facility and the concept of inter-generational equity should guide this decision.

Escrow Structuring

The Agency shall utilize the least costly securities available in structuring refunding escrows. The Agency will examine the viability of an economic versus legal defeasance on a net present value basis. A certificate from a third party agent, who is not a broker-dealer, is required stating that the securities were procured through an arms-length, competitive bid process (in the case of open market securities), that such securities were more cost effective than State and Local Government Series Obligations (SLGS), and that the price paid for the securities was reasonable within Federal guidelines. Under no circumstances shall an underwriter, agent or financial advisor sell escrow securities to the Agency from its own account.

Arbitrage

The Agency shall take all necessary steps to optimize escrows and to avoid negative arbitrage in its refunding. Any resulting positive arbitrage will be rebated as necessary according to Federal guidelines.

METHODS OF ISSUANCE

The Agency will determine, on a case-by-case basis, whether to sell its bonds competitively or through negotiation.

Competitive Sale

In a competitive sale, the Agency'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. Conditions under which a competitive sale would be preferred are as follows:

- 1) Bond prices are stable and/or demand is strong
- 2) Market timing and interest rate sensitivity are not critical to the pricing
- 3) Participation from DBE firms is best efforts and not required for winning bid
- 4) There are no complex explanations required during marketing regarding issuer's projects, media coverage, political structure, political support, funding or credit quality
- 5) The bond type and structure are conventional
- 6) Manageable transaction size
- 7) Proposed security and repayment source have strong credit rating
- 8) Proposed security and repayment source are well known to investors

Negotiated Sale

The Agency recognizes that some securities are best sold through negotiation. Conditions under which a negotiated sale would be preferred are as follows:

- 9) Bond prices are volatile
- 10) Demand is weak or supply of competing bonds is high
- 11) Market timing is important, such as for refundings
- 12) Proposed security and repayment source have lower or weakening credit rating
- 13) Proposed security and repayment source are not well known to investors
- 14) Sale and marketing of the bonds will require complex explanations about the issuer's projects, media coverage, political structure, political support, funding, or credit quality
- 15) The bond type and/or structural features are non-standard, such as for a forward delivery bond sale, issuance of variable rate bonds, or where there is the use of derivative products
- 16) Early structuring and market participation by underwriters are desired
- 17) The par amount for the transaction is significantly larger than normal
- 18) Demand for the bonds by retail investors is expected to be high
- 19) Participation from DBE firms is desired

Private Placement

The Agency may elect to privately place its debt. Such placement shall only be considered if this method is demonstrated to result in a cost savings to the Agency relative to other methods of debt issuance or the terms and conditions of a private placement are more favorable to the Agency than those terms achieved through a publicly sold transaction.

MARKET RELATIONSHIPS

Rating Agencies and Investors

The Chief Financial Officer shall be responsible for maintaining the Agency's relationships with Moody's Investors Service, Standard & Poor's and Fitch Ratings, as appropriate. The Agency may, from time-to-time, choose to deal with only one or two of these agencies as circumstances dictate. In addition to general communication, the Chief Financial Officer shall: (1) meet with credit analysts on a periodic basis to provide program updates, (2) prior to each competitive or negotiated sale, offer conference calls with rating agency analysts in connection with the planned sale and (3) ensure the prompt delivery of pertinent public documents including, but not limited to, the Agency's Annual Financial Statements and Bi-Annual Budgets.

Agency Communication

The Chief Financial Officer shall include in the annual report to the Board feedback from rating agencies and/or investors regarding the Agency's financial strengths and weaknesses and recommendations for addressing any weaknesses.

Continuing Disclosure and Other Post Issuance Compliance

The Agency shall remain in compliance with Rule [15c2-12] by filing its annual financial statements and other financial and operating data for the benefit of its bondholders within 210 days of the close of the fiscal year. While there is reliance on timely audit and preparation of the Agency's annual report, the Chief Financial Officer will ensure the Agency's timely filing with the Electronic Municipal Market Access ("EMMA"). The Agency shall work with its disclosure counsel to ensure that Official Statements for specific issuances contain a summary of the Agency's continuing disclosure obligations.

In addition to complying with all applicable continuing disclosure requirements, the Agency will comply with any other financial covenants as required by the documents governing specific bond issuances including IRS Arbitrage Rebate Requirements which are discussed below.

Rebate Reporting

The use of bond proceeds and their investments must be monitored to ensure compliance with arbitrage restrictions. Existing regulations require that issuers calculate annual rebates related to any bond issues, with rebate paid every five years. Therefore, the Chief Financial Officer shall ensure that proceeds and investments are tracked in a manner that facilitates accurate, complete calculation, and timely rebates, if necessary.

PROFESSIONALS

The Agency shall select its primary professional(s) by competitive process through a Request for Proposals (RFP).

Selection of Financing Team Members

The Chief Financial Officer will oversee the selection process for the Agency's financial advisors, underwriters (under a negotiated sale) and other financing team members. The City Attorney's Office will oversee the selection process for legal professionals for the Agency's financings, including the selection of Bond Counsel and Disclosure Counsel.

Financial Advisor

The Agency shall utilize a financial advisor(s) to assist in its debt issuance and debt administration processes. Selection of the Agency's financial advisor(s) shall be based on, but not limited to, the following criteria:

- 20) Experience in providing consulting services to complex issuers
- 21) Knowledge and experience in structuring and analyzing complex issues
- 22) Experience and reputation of assigned personnel
- 23) Fees and expenses

Financial advisory services provided to the Agency shall include, but shall not be limited to the following:

- 24) Evaluation of risks and opportunities associated with debt issuance
- 25) Monitoring marketing opportunities
- 26) Evaluation of proposals submitted to the Agency by investment banking firms
- 27) Structuring and pricing
- 28) Preparation of request for proposals for other financial services such as trustee and paying agent services, printing, credit facilities, remarketing agent services, etc.
- 29) Advice, assistance and preparation for presentations with rating agencies and investors

The Agency also expects that its financial advisor will provide the Agency with objective advice and analysis, maintain the confidentiality of Agency financial plans, and be free from any conflicts of interest.

Bond Counsel

The Agency shall retain one or more bond counsel firms to provide ongoing legal advisory services with respect to the Agency's outstanding and proposed bonds and related agreements, including without limitation credit facilities, investment agreements and other similar matters.

Agency debt will include a written opinion by legal counsel affirming that the Agency is authorized to issue the proposed debt, that the Agency has met all constitution and statutory requirements necessary for issuance, and a determination of the proposed debt's federal income tax status. The approving opinion and other documents relating to the issuance of debt will be prepared by counsel with extensive experience in public finance and tax issues.

Disclosure Counsel

The Agency may retain a disclosure counsel firm to provide ongoing legal advisory services with respect to initial and continuing disclosure in connection with the Agency's outstanding and proposed bonds. The issuance of bonds by the Agency shall require a written opinion from the Agency's disclosure counsel, as appropriate, regarding (i) the exemption of the bonds from

registration requirements under Federal securities laws, and (ii) their absence of knowledge, after due review, regarding any material misstatement in or omission from the official statement or other public offering document with respect to the bonds.

Dissemination Agent

The Agency may retain a dissemination agent to provide continuing disclosure agreements on behalf of the Agency for the purpose of filing annual reports and event notices with Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) and State information depositories. The dissemination agent service shall be provided by either the disclosure counsel, trustee or other appropriate party.

Trustee and Fiscal Agent

The Agency may engage bond trustees and/or fiscal agents and paying agents, as necessary or appropriate, in connection with the issuance of its bonds. Bond trustees and fiscal agents shall have a minimum capitalization of \$100 million.

Arbitrage Rebate Consultant

The Agency may engage an arbitrage rebate consultant to help identify the most cost-effective way of satisfying the IRS arbitrage rebate reporting requirements connected to issuance of tax-exempt securities and to perform the periodic required arbitrage calculations that must be submitted to the IRS.

Liquidity and Credit Facility Providers

When deemed to be prudent in the context of a specific financing, the Agency shall solicit competitive bids for liquidity and/or credit facilities from a broad number of qualified providers that satisfy the requirements for that specific financing.

Underwriter(s)

SENIOR MANAGER SELECTION

The Agency shall have the right to select a senior manager for a proposed negotiated sale. The criteria shall include but not be limited to the following:

- a) The firm's ability and experience in managing complex transactions
- b) The firm's willingness to provide support with capital and demonstration of such support
- c) The firm's ability to sell bonds
- d) Quality and experience of personnel assigned to the Agency's engagement
- e) Financing plan presented

f) Such other appropriate criteria as determined by the Agency

CO-MANAGER SELECTION

Co-managers will be selected on the same basis as the senior manager. Co-managers appointed to specific transactions will be appointed based on of the size of the bond issuance and the necessity to ensure maximum distribution of the Agency's bonds.

SELLING GROUP

The Agency may establish a selling group to increase the distribution of bonds in negotiated transactions. To the extent that selling groups are used, the Chief Financial Officer at his or her discretion may make appointments to a selling group.

UNDERWRITER'S DISCOUNT AND SYNDICATE POLICY

The Agency will evaluate the proposed underwriter's discount against comparable issues in the market. If there are multiple underwriters in the transaction, the Agency will determine the allocation of fees with respect to the underwriter's discount and management fee, if any. The determination will be based, in part, upon participation in the structuring phase of the transaction.

EVALUATION OF FINANCING TEAM PERFORMANCE

The Agency will evaluate each bond sale after its completion to assess the following: costs of issuance including underwriters' 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 credits.

INVESTMENT OF BOND PROCEEDS

All investments of bond proceeds shall adhere to the City of San Francisco's Investment Policy approved periodically by the County Treasurer Oversight Committee. With the exception of guaranteed investment contracts, investments shall not allow security types or credit standards less than those of the Treasurer's Investment Policy. The permitted investment guidelines from the City's Investment Policy will be incorporated into the relevant bond documents at the time issuance.

BOND OVERSIGHT COMMITTEE

The SFMTA Board shall establish a bond oversight committee. The purpose of the committee shall be to inform the SFMTA Board and the public on the expenditure of bond proceeds issued by the SFMTA. The Committee shall convene to provide oversight to ensure that bond proceeds are expended only in accordance the bond documents and approving legislation and projects or expenditures funded by bond proceeds are delivered timely.