INTRODUCTION

Palo Verde Community College District (the "District") is a political subdivision of the State of California, organized for the purpose of providing a community college educational program to more than 8,000 students on two campuses. The District serves an area of about 7,027 square miles in the eastern portions of both San Bernardino and Riverside counties. The District is governed by a seven-member Board of Trustees (the "Board"). The Board's primary functions are to provide for the general operation and personnel of the District, to oversee the property, facilities and financial affairs of the District, and to establish policies for the District. The Superintendant/President of the District is responsible for administering the affairs of the District in accordance with the policies and direction of the Board and for supervision of the District's other key personnel. This debt policy (the "Policy") has been crafted in recognition of the unique organizational and advisory role played by the Board and the responsibility of the Superintendant/President to execute on the Board's adopted policies.

In accordance with Accreditation Standards, the Board is responsible for acquisition and management of college debt and has the authority to approve business transactions which result in debt obligations for the District. Debt is defined as any significant financial agreement or transaction of more than $1,000,000, exclusive of those resulting from day-to-day operations, which result in significant short or long-term payment obligations.

OVERVIEW & POLICY STATEMENT

The policy of the Palo Verde Community College District is not to incur any debt unless a justification for such debt has been presented to the Board for discussion and approval. Standard debt obligations include those funding mechanisms associated with cash flow, revenue deferrals, emergency need, etc. in which short-term transitions are required to meet immediate financial obligations, but which include full debt resolution within an established timeframe. All agreements (TRANS, COPs, Bonds, etc.) which incur a debt obligation for the District shall be approved by the Board and shall be accompanied with a debt management plan for the short or long-term debt repayment.

POLICY PURPOSE

It is the Board's intention in adopting this Policy to promote the prudent evaluation of proposals to incur District indebtedness. It is the intent that this Policy be informed by "best practices and advisories" developed by organizations such as the Government Finance Officers Association ("GFOA"), which

recommends that all state and local governments adopt comprehensive written debt management policies. This Policy has been drafted with reference to the guidance of the GFOA as of the date of adoption. It is understood that the GFOA amends and modifies its guidance over time. This Policy will set guidelines for the analysis of debt to be issued by the District, the issuance process, and the management of outstanding District indebtedness. The Policy is intended to enhance the quality of decisions about debt affordability, structure and financial management. In addition, the Policy also reflects the unique objectives and risk tolerances of the District and the Board.

The President/Superintendant will review the GFOA's Best Practices and Advisories from time to time and recommend conforming modifications to this Policy, if warranted.

This Debt Policy should be read in its entirety, and read in conjunction with other Policies as such policies may be applicable to the context of the review of either existing or proposed indebtedness.

POLICY SCOPE

This Policy addresses the methods, procedures, and practices that will ensure prudent management of the District's debt. The guidelines contained in this Policy apply to most long-term debt obligations and many short-term obligations.

Long-term obligations may take the form of general obligation bonds or lease agreements. Lease agreements often take the form of "certificates of participation" (COPs) that create undivided interests in the right to payments under lease purchase agreements relating to the District's fixed assets.

Short-term obligations, payable during the same fiscal year in which they are issued (or immediately thereafter so long as payments are made from moneys in the budget for that fiscal year), may take the form of tax and revenue anticipation notes or loan agreements, including loan agreements between the District and a private lender, such as a bank.

Debt financing should generally not be considered an additional source of revenue. Debt is merely a way of spreading out the cost of a capital improvement or public program over time. In some cases (as with general obligation bonds), the statutes permitting the issuance of the debt also permit the levying of taxes or assessments to pay debt service.

There are many variations on the structure and security for bonds. These include bonds which are general obligations (payable from all general funds of the issuer) and those which are limited obligations (payable from only a specified source of funds, such as lease or rental payments on a particular asset), bonds which have one maturity date and those with multiple maturity dates, and bonds with fixed interest rates and those with variable interest rates.

Lease purchase agreements and COPs that are subject to annual appropriation, and short-term obligations, are not debt or multiple fiscal-year financial obligations and payments on them are not treated as debt under California law but are often referred to as "debt" and "debt service" for purposes of this Policy. Those references are not intended to change the treatment of such obligations or payments under California law. The distinction is that lease arrangements are "executor contracts" and require the Board to budget for, and appropriate, funds in future years to meet the debt service requirements on such obligations.

The issuance of debt has significant long-term implications for the District. Accordingly, consideration will be given to the principles of equity (such that those who pay for the debt are those who benefit from the facilities funded by the issuance of such obligations), essentiality (if the debt finances an asset, the financed asset is essential to the District's core operation) and efficiency (the identified revenue source is sufficient to meet the debt service, and the cost of obtaining funds is less than competing alternatives).

GENERAL OBLIGATION DEBT

General obligation bonds are voter-approved; thus, the Board in approving them is relying on the authority of the taxpayers in the District and the additive funds arising from taxation of real and personal property within the District's boundaries to repay such debt. General obligation bonds are the simplest type of long-term bond. General obligation bonds are secured by a promise to levy *ad valorem* taxes in an unlimited amount as necessary to repay the indebtedness.

In general, community college districts in California may issue general obligation bonds for the purpose of (1) purchasing real estate to be used for a school-related facility; (2) building or purchasing school buildings; (3) making alterations or additions to school buildings, provided that the alterations or

additions do not constitute current maintenance; (4) repairing school buildings that are damaged by fire, earthquake or other calamities; and, (5) refinancing of outstanding indebtedness.

General obligation bonds may be used only for the purposes approved by the voters. Taken together, the statutes authorizing the election and the issuance of the bonds, the resolution calling the election, and the specific language contained in the ballot measure itself, create a manner of contract which is binding upon the District once the voters have given their assent.

The ballot measure proposed to the voters must recite the purposes for which the proceeds will be used, but the local agency's governing body may choose how precisely or how generally to state those purposes. A general statement of the question usually preserves the flexibility for the issuer of the general obligation bonds to spend bond proceeds as it wishes, within the terms of the authorization. This is true despite any specific promises or assertions made by public officials or bond supporters at the time of the election, including those made in official plans, ballot arguments, or campaign propaganda.

*G*eneral obligation bonds generally offer the lowest borrowing costs because the broad pledge of *ad valorem* taxation generates the widest investor acceptance. A “reserve fund” is usually not required (or even permitted), leaving more bond proceeds for project purposes (or keeping the bond amount to the minimum necessary.) Many financing terms are dictated by statute, often allowing the legal documentation to be less complex than for other types of bond issues. Perhaps most importantly, issuers of general obligation bonds are guaranteed that their operating funds will not be diverted to pay debt service on the bonds because the levy of taxes is “additive” to the operating funds.

There are some requirements that may be challenging for the use of general obligation bonds. They include: (1) the requirement for voter-approval; (2) the expense of conducting an election, especially if the election has a limited probability of approval of the bond issue; and, (3) the limitations on the use of proceeds of the bonds, especially the requirement that proceeds be used for real property and buildings only.

LEASE FINANCING

A financing lease provides a public agency with an alternative to issuing bonds to finance capital assets over a multi-year period. A tax-exempt lease financing typically falls into one of two general categories:

(1) a public agency may finance a capital asset by leasing it directly from the vendor or leasing company, with the lessor receiving a portion of each rental payment as tax-exempt interest, or (2) in the event the public 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. This latter approach is very common in California.

In analyzing a lease financing, it is important to remember that the public agency is using its authority to acquire or dispose of property, rather than its authority to incur debt. While the terms "tax-exempt lease" or "financing lease" are used herein, the obligation may be structured as an installment purchase agreement, installment sale agreement, or lease-purchase agreement, as explained further below.

A typical certificate of participation (COP) financing for a construction project or acquisition of a capital asset might be structured as follows. A public agency enters into a tax-exempt lease with a nonprofit corporation, JPA, leasing company, bank, or other lessor. The lessor acquires the applicable site, either by purchasing it from a third party or by leasing it from the public agency. The lessor, with the assistance of the public agency, undertakes the construction of the project to be located on the site and leases the improved site to the public agency pursuant to a financing lease. The lessor's rights to receive payments under the lease are assigned to a trustee, which executes and delivers to an underwriter, COPs in the lease payments. A portion of each lease payment is designated as tax-exempt interest. The proceeds of the sale of the COPs are used to pay the costs of acquiring and constructing the improvements.

A tax-exempt lease may be used to finance any property that the public agency has the statutory authorization to lease. As a general matter, only land and depreciable property will satisfy legal and investor preference tests. Generally, the leased property is a capital asset to be used by the public agency in its own operations. Community college districts are authorized under California law to enter into lease financings and to convey district property to a lessor for the purpose of leasing it back if the annual rent payable by the district is subject to annual appropriation and does not exceed the fair rental value of the leased property.

So-called asset transfer financings follow the basic pattern of a tax-exempt lease financing. However, in this type of financing, the property that is the subject of the lease (typically an unencumbered public improvement such as a government building) is already owned by the public agency lessee. The lessee

leases or sells the property to a lessor (purchaser) and immediately leases (or repurchases) the property back. Often, the funds derived from an asset transfer financing are deposited into a capital improvement fund or other building or construction fund to pay the cost of construction or acquisition of various public improvements. In addition, the lessor (purchaser) will often raise funds to purchase the property by assigning the right to receive payments to a trustee, without recourse, who will execute and deliver COPs. The asset transfer structure allows a public agency to meet current capital requirements by realizing cash from the value of existing, unencumbered assets. In the event the leaseback is structured as a long-term lease, the public entity can begin making lease payments immediately since it has immediate use and occupancy of the existing improvements, and thus there is no need to capitalize interest during the construction period for the project to be financed and no risk associated with noncompletion of the construction project.

SHORT-TERM FINANCING

Market participants generally call municipal securities short-term if they have maturities of less than three years or if they have features that shorten their effective maturities to less than three years. The municipal market includes several short-term financing vehicles. Notes such as tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs), tax anticipation notes (TANs), and grant anticipation notes (GANs) provide funds for short periods. Short-term notes are repaid from the proceeds of bond issues, taxes, or revenue-producing projects.

Public agencies may issue short-term notes in anticipation of collecting some form of revenue, tax, or bond proceeds. A TRAN (a tax and revenue anticipation note) is a combination of tax and revenue anticipation. Bond anticipation notes, or “BANs” are issued prior to a bond issuance by a public agency. They are considered to be the riskiest short-term municipal note because they are contingent on the agency’s ability to issue bonds at some point in the future. Accordingly, they create “market access risk” that could prevent the public agency from selling, then closing, a long-term debt issue and thus, having to pay off the entire amount of the maturing BAN from other funds.

The most widely-issued note in California is the TRAN. TRANs are issued by public agencies to fund cash flow deficits in a fiscal year. Typically, they would be issued at the beginning of the fiscal year and mature at the end of such fiscal year. While such borrowings are not without risk, the benefits may

outweigh those risks, if the public agency's cash flow requirements dictate a need for working capital funding.

DEBT ISSUANCE CONSIDERATIONS

The issuance of debt is subject to a set of terms that ensure oversight and fiscal prudence. This Policy is intended to be consistent with the guidance provided by the GFOA as it relates to new and refunding issues, which further encourages that legal and independent financial advice be sought early in this process to raise key legal, tax, and financial issues.

In general terms, it shall be the policy of the District that

1. Debt shall comply with all applicable laws, regulations, and covenants and shall not be issued so as to jeopardize the status of outstanding debt.
2. Capital improvements may be financed utilizing the issuance of general obligation bonds, subject to voter approval, or from time to time through lease purchase obligations.
3. Principal and interest payment schedules will be structured to result in level debt service payments.
4. Debt structures will generally be limited to current interest serial or term maturities, and the use of capital appreciation bonds or similar structures that "back-load" the District's debt will be avoided.
5. The average life of debt issued to finance assets shall be no greater than the projected average life of the assets being financed.
6. The District may issue refunding bonds to reduce the interest cost on its outstanding debt or other obligations for other purposes allowable under state law when (a) such refunding will achieve present value savings of at least 3% compared to the debt service on the obligations being refunded; and, (b) will not require extending the maturity of the bonds beyond that of the bonds being refunded.

DEBT AFFORDABILITY

The District shall conduct a Debt Assessment Report in advance of any contemplated voter referendum on the issuance of general obligation bonds. The Report will be prepared with advisory or consultancy support as required. Such planning analyses of debt affordability will serve to make rational the assessment of the ability of the District to carry additional debt service. A Debt Assessment Report

signals to the public, to the rating agencies, and to the investment community that the District is taking seriously its fiduciary role in the oversight and management of its debt. The President/Superintendant shall evaluate and consider the results of the Debt Assessment Report when making recommendations about the issuance of debt. The Report, along with the Superintendant/President's review, may consider the following factors:

1. An analysis of the operating strength and aggregate debt burden of the District, relative to peer Districts, using metrics related to population, property values, wealth indicators and other such credit factors;
2. An assessment of implications of the proposed financing for the District's credit rating and credit capacity;
3. An analysis of financing and funding alternatives and a summary of the true interest cost of the proposed financing; and
4. An overview of the plan in the context of other capital needs.

If justified and approved by the Superintendent/ President, the recommendation to incur additional debt, including the Debt Assessment Report and Auditor comments, will be presented to the Board's Finance & Audit Committee for approval.

If approved by the Board's Finance & Audit Committee, a Special Study Session will be held by the Board of Trustees to review, discuss, and consider the implications and impact on the District's budget and operations with or without the debt acquisition. The Special Study Session will be structured as follows:

1. The external financial expert will present the debt assessment report.
2. The District's Auditor will present their comments/concerns.
3. The Chief Business Officer will present the justification for the debt acquisition and the Debt Management Plan.
4. College constituent groups will be afforded the opportunity to comment on the proposed debt acquisition.

The proposed debt acquisition will be presented to the Board of Trustees for 1st Read (no action) and 2nd Read (action) prior to final approval.

References and Citations: GFOA Best Practice, Investment of Bond Proceeds, 2007; GFOA Best Practice, Debt Management Policy, 2003; Debt Issuance and Management: A Guide for Smaller Governments, James C. Joseph, GFOA, 1994; "*Understanding Current and Advance Refundings*," Government Finance Review, April 1992; Approved by the GFOA's Executive Board, February, 201; *Disclosure Handbook for Municipal Securitie*s, National Federation of Municipal Analysts, 1992; "Securities and Exchange Commission Enforcement Actions in the Municipal Securities Markets," *Government Finance Review*, August 1996; *Making Good Disclosure*, Robert Dean Pope, GFOA, 2001; GFOA Best Practice, "Using a Web Site for Disclosure," GFOA, 2002; GFOA Best Practice, Web Site Presentation of Official Financial Documents, 2009; GFOA Best Practice, "Understanding Your Continuing Disclosure Responsibilities, 2010; *Disclosure Roles of Counsel*, John McNally, Project Coordinator, ABA/National Association of Bond Lawyers, 2009; EMMA - http://emma.msrb.org/; California Debt Issuance Primer, California Debt and Investment Advisory Commission, 2005.