STATE OF FLORIDA

THE DIVISION OF BOND FINANCE

DEBT MANAGEMENT POLICY

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DEBT MANAGEMENT POLICY

I. INTRODUCTION

The Need for and Purpose of a Debt Management Policy

The State of Florida has funded significant infrastructure needs for schools, roads and preserving land to meet the needs of a growing population. The funding of this investment in infrastructure has been provided through a combination of pay-as-you-go appropriations and issuing significant amounts of debt. The vast majority of long-term obligations incurred by the State are through bonds authorized by the legislature and issued under oversight by the Governor and Cabinet. The increasing reliance on debt to fund needed infrastructure makes it fiscally prudent to formalize guiding principles to govern the issuance and sale of State debt.

Proper management of debt is fundamental to sound financial management practices and protecting the financial condition of the State. The Governor and Cabinet, sitting as the governing board of the Division of Bond Finance, recognize that the foundation of managing debt is a comprehensive debt management policy. This debt management policy sets forth parameters and provides guidance regarding the following decisions:

a) the amount of debt which may prudently be issued;
b) the purposes for which debt may be issued;
c) structural features of debt being issued;
d) the types of debt permissible;
e) the preferred method of sale;
f) the selection of professionals;
g) compliance with securities laws and disclosure requirements; and,
h) compliance with federal tax laws and arbitrage compliance.

The purpose of this debt management policy is to provide broad policy guidance regarding State debt. This will facilitate the management, control and oversight of the State's debt function facilitating ongoing access to the capital markets critical to the financing of needed infrastructure.

The following policies are intended to provide guidance in the structuring and sale of State debt. However, exceptions to the general principles set forth may be appropriate under certain circumstances after careful consideration of the facts of each case. Also, additional guidelines and policies may be necessary as new or innovative financial products and debt structures evolve over time.

Scope, Approval and Review of Policy

This debt management policy applies to all debt or debt-related obligations issued by the Division of Bond Finance. In addition, it is recommended that other State agencies and instrumentalities, including quasi-public corporations encumbering State resources, follow these guidelines as well.

This debt management policy has been approved by the Governor and Cabinet sitting as the governing board of the Division of Bond Finance. The Governor and Cabinet intend for these policies to apply to debt and other long-term obligations incurred by State agencies directly and commitments of State resources by conduit issuers or special-purpose corporations.

In connection with preparing the annual debt affordability analysis discussed below, the Division of Bond Finance shall review this debt management policy and make appropriate recommendations for amendments or additions. More frequent recommendations for amendments or additions may be made as circumstances warrant.

II. DEBT AFFORDABILITY

Concept of Affordability

One of the most important components of an effective debt management policy is an analysis of what level of debt is affordable given a particular set of circumstances and assumptions. More comprehensive than simply an analysis of the amount of debt that may be legally issued or supported by a security pledge, it focuses on the totality of an issuer=s debt burden as opposed to evaluating each bond issue individually or on a programmatic basis. Additionally, the level of debt should be analyzed in relation to the financial resources available to the State to meet its debt service obligations.

An analysis of debt affordability should address the impact of existing and proposed debt levels on an issuer=s debt ratios as well as the impact on its proposed capital and operating budgets. The analysis should apply widely recognized debt measurements to analyze the issuer=s debt position, peer-group comparisons to establish rankings relative to other comparable States, and offer guidelines or ranges to policymakers for their use in allocating limited resources.

Annual Analysis

The Division of Bond Finance will prepare, annually, a debt affordability analysis and present the results to the Governor and Cabinet prior to submission of the Governor=s recommended budget to the legislature. This analysis will consider existing and planned debt issuance for the State's capital needs and available financial resources. Any new financing proposal should be analyzed for its effect on the debt affordability analysis and the credit quality of existing programs. The information provided by the analysis should be made available to policymakers to assist them in prioritizing capital spending and evaluating the long-term financial impact of borrowing decisions. This exercise will benefit the State by helping integrate the capital budgeting and debt management process.

Elements of Analysis

The annual debt affordability analysis should address the following, unless the Director of the Division of Bond Finance determines that other factors should be included or are more appropriate to the analysis:

a) the State=s current debt position;
b) meaningful measures of debt affordability and peer-group comparisons; and,
c) an estimate of the State=s available debt capacity within the guideline range.

In preparing the debt affordability analysis, a distinction should be made between self-supporting and net tax-supported debt. Self-supporting debt includes obligations paid from user fees. Net tax-supported debt includes all debt paid from State revenues other than obligations secured by user fees or non-traditional revenue sources. Because net tax-supported debt directly impacts general governmental operations and prospective budgetary flexibility, it should be used to determine future debt capacity available.

The debt affordability analysis should apply the following debt measures to evaluate the State=s historical debt position, assess the impact of proposed debt issuance and determine future debt capacity available:

a) debt service as a percentage of revenues available to make debt service payments;
b) net tax-supported debt as a percentage of personal income; and,
c) net tax-supported debt per capita.

The estimate of the State=s theoretical debt capacity should show the level of debt which the State could issue in excess of amounts currently planned for both existing and approved new programs. The estimated debt capacity should be calculated based on the ratio of total annual net tax-supported debt service as a percentage of forecasted general revenues and trust fund revenues pledged to debt service, applying a target of 6% and a cap of 8%. The Governor's Office of Planning and Budgeting should be notified in the event projected debt issuance exceeds either the 6% target or 8% cap.

The level of reserves is also an important measure of financial stability. The traditional measure used is the amount of reserves available to the State as a percentage of general revenues. This measure indicates the State=s ability to effectively deal with economic downturns or unexpected expenditures and is a consideration in determining the State's credit rating. Therefore, the level of reserves should be monitored annually.

III. GENERAL DEBT ISSUANCE POLICIES

Purposes for Which Debt Can Be Issued and Evaluation of Proposed Financings

Bonds should be issued only to finance or refinance capital assets. Self-supporting debt should be issued for system improvements or expansion, as system needs warrant, and at levels which can be supported from operating revenues while maintaining existing credit ratings. Refunding bonds may be issued to achieve debt service savings. Refunding bonds may also be issued to restructure outstanding debt service or to revise provisions of bond documents if it can be demonstrated that the refunding serves a compelling State interest.

Projects being financed through the issuance of bonds, certificates-of-participation, long-term leases or any other contracted arrangement requiring payments by the State in future years must provide tangible, demonstrable benefits to the State. Revenue producing projects or projects being financed with self-supporting debt will be evaluated based on an expected return on investment or internal rate of return. Non-revenue producing projects or projects being financed with tax-supported debt such as schools, prisons, non-tolled roads, etc., shall be evaluated based on criteria and metrics appropriate for the type of project. Each agency that is responsible for administering bond proceeds or is the user of the project being financed shall provide an analysis of the costs and benefits of each project in connection with any request for authority to issue bonds or incur debt and shall also provide a report evaluating actual verses expected performance/results for all projects previously financed.

The use of available cash to fund all or a part of the cost of capital improvements should be explored before proposing the issuance of long-term debt for such purposes.

Committing State Resources for Debt Not Issued by State

There may be occasions where the State considers committing, or creating a mechanism which allows other entities to commit, State financial resources on a long-term basis in support of debt not issued by the State, such as debt sold by quasi-governmental entities, not-for-profit corporations or local governments. While the nature of the commitment may not constitute a legal debt obligation of the State, it may affect the State's debt position and its available financial resources. Therefore, it is recommended that the State not obligate its resources, directly or indirectly, through any debt-related commitment without first assessing the long-term impact upon the State's debt position and available resources, and that, to the extent practicable, this debt management policy be followed in the issuance of such debt.

Credit Ratings

In order to access the credit markets at the lowest possible borrowing cost, it is recognized that credit ratings are critical. Therefore:

a) for existing bond programs, the State shall strive to maintain or improve current credit ratings without adversely impacting levels of debt which may be issued for any particular program; and,

b) for all new programs, the State shall seek to structure the program to achieve a minimum rating of AA@ from at least two nationally recognized rating agencies. Credit enhancement may be used to achieve this goal.

Tax Status

The State has traditionally issued tax-exempt debt which results in significant interest cost savings compared with the interest cost on taxable debt. Accordingly, all State debt should be issued to take advantage of the exemption from federal income taxes unless prohibited by federal law or applicable federal regulations.

Security Features

Security which may be pledged. The State may sell debt or enter into transactions involving the sale of debt secured, directly or indirectly, by revenues or assets of the State. There is a preference that, to the extent permitted by law, there be a nexus between the revenue pledged and the specific purpose for which the debt is issued. For example, a pledge of gasoline taxes should be used to support debt issued for transportation purposes, where legally permissible.

In certain circumstances, the security pledged to repay debt may be subject to annual appropriation by the legislature. However, the failure by the legislature to appropriate moneys required to fulfill its obligations would severely damage the State=s reputation in the credit markets. Therefore, the State should not fail to appropriate amounts necessary to satisfy the State=s obligations on any debt or to fulfill any covenants made in connection with the sale of bonds.

Lien Status. All bonds of a particular program should be secured by a first lien on specified revenues. Additionally, bonds should generally be equally and ratably secured by the revenues pledged to the payment of any outstanding bonds of a particular bond program. However, the creation of a subordinate lien is permissible if a first lien is not available or circumstances require.

Reserve Fund. A debt service reserve fund for any particular bond issue or program may be funded and maintained to achieve desirable credit ratings. Funding of the reserve requirement can be by deposit of bond proceeds, purchase of a reserve-fund credit facility, or funding from available resources over a specified period of time.

Credit Enhancement. Credit enhancement is used primarily to achieve interest cost savings. The purchase of credit-enhancement products is permissible provided the purchase is done in a cost-effective manner. Therefore, if it is determined by the Director of the Division of Bond Finance that the use of credit enhancement should be considered, the following practice should be observed to the extent practicable:

a) with respect to bonds sold through competitive sale and which have been rated, the bonds should be qualified for credit enhancement and the syndicates bidding on the bonds should be permitted to decide whether to use credit enhancement and to choose the provider of the enhancement;

b) with respect to bonds sold through negotiated sale, bids should be solicited from providers of credit enhancement and a determination made whether the enhancement will provide appropriate debt service savings; or,

c) with respect to bonds which have not been rated, bids should be solicited from providers of credit enhancement and a determination made whether the enhancement will provide appropriate debt service savings.

There may be a different procurement process for selecting credit enhancement providers as long as the selection is done in a fair and cost-effective manner and results in appropriate debt service savings to the State.

Capitalized Interest. Capitalized interest from bond proceeds is used to pay debt service until a revenue producing project is completed or to manage cash flows for debt service in special circumstances. Since the use of capitalized interest increases the cost of the financing, it should only be used when necessary for the financial feasibility of the project.

Structural Features

Length of Maturity. In addition to any restriction on the final maturity imposed by the constitution or laws of the State, there is a preference that the final maturity on bonds not exceed thirty years from the issuance date. Additionally, the duration of the debt should be shortened to the extent practical to minimize the interest cost on the financing. Lastly, the final maturity of the debt should not exceed the estimated useful life of the assets being financed unless it serves a compelling State interest.

Debt Service Structure. All debt should be structured on a level debt basis, i.e., so that the annual debt service repayments will, as nearly as practicable, be the same in each year. Although a different debt service structure is permissible, depending upon particular circumstances, the strong preference is that any deviation from the level debt structure should be for debt service payments to be larger in the early years and lower thereafter and not to have the payments lower in the early years and higher thereafter. A deviation from these preferences is permissible if it can be demonstrated to serve a compelling State interest.

Redemption Prior to Maturity. A significant tool in structuring governmental bonds is the ability to make the bonds callable after a certain period of time has elapsed after issuance. This provides the advantage of enabling the issuer to achieve savings through the issuance of refunding bonds in the event interest rates decline. Although the ability to refund bonds for a savings is advantageous, there may be situations where the State may realize greater benefit of lower interest rates by issuing the bonds as non-callable. Accordingly, there is a strong preference that State bonds be structured with the least onerous call features as may be practical under then prevailing market conditions. The Director of the Division of Bond Finance, however, may make a determination that bonds of a particular issue should be sold as non-callable if, in his judgment, circumstances warrant.

Interest Accrual Features

Fixed Rate, Current Interest Debt. The State has traditionally issued conventional fixed-rate debt with interest payable semi-annually to bondholders. The advantage of fixed-rate debt is the long-term certainty provided by locking in the State's interest cost and not being subject to increased cost because of interest rate changes. Fixed-rate debt should be continued as the primary means of financing infrastructure and other capital needs. However, there may be certain limited circumstances where variable-rate debt is more appropriate, in which case an exception should be made in accordance with the policies governing variable-rate debt herein.

Derivatives. Alternative financing arrangements, generally referred to as derivatives, are available in the market as an alternative to traditional bonds. Under certain market conditions, the use of alternative financing arrangements may be more cost effective than the traditional fixed income markets. However, these alternative financing instruments, such as fixed-to-floating swap agreements, have characteristics and carry risks peculiar to the nature of the instrument which are different from those inherent in the typical fixed-rate financing. Although the State should normally continue issuing conventional fixed-rate bonds, the State may enter into alternative financing instruments when the inherent risks and additional costs are identified and proper provision is made to protect the State from such risks. Additionally, in determining when to utilize alternative financing arrangements, the availability of the requisite technical expertise to properly manage the risks and execution of the transaction should be evaluated along with any additional ongoing administrative costs of monitoring the transaction.

Capital Appreciation Bonds. Capital appreciation bonds and other similar debt instruments pay no interest until their stated maturity. Although there may be extraordinary circumstances in which the use of capital appreciation bonds is fiscally prudent, in most cases the debt service deferral is not appropriate and should be discouraged. Accordingly, only when a compelling State interest is demonstrated should capital appreciation bonds be issued.

Variable-Rate Bonds. As contrasted with fixed-rate bonds, bonds may also be issued with variable rates of interest. The interest rate on variable-rate bonds changes periodically, e.g., daily, weekly or monthly. Bonds whose interest rate changes weekly are the most common type of variable-rate debt. A significant advantage of variable-rate bonds is that they typically carry an initial interest rate lower than that of a fixed-rate bond issued at the same time. A significant disadvantage is that interest rates may rise and the interest rate on the variable-rate bonds may increase to levels higher than the rate which could have been obtained on fixed-rate bonds. Selling variable-rate bonds also leads to uncertainty regarding the State's annual budget requirements for debt service and the total cost of the financing over the life of the bonds. Other advantages, disadvantages and risks may become manifest in a particular transaction and should be considered. Variable-rate bonds may be issued where, considering the totality of the circumstances, such bonds can reasonably be expected to reduce the total borrowing cost to the State over the term of the financing. The availability of the requisite technical expertise to properly manage the risks and execution of the variable-rate transaction should be evaluated along with any additional ongoing administrative costs of monitoring the transaction. The following guidelines should apply to the issuance of variable-rate debt:

a) *Expected reduction in total borrowing cost*. In determining reasonably expected savings, a comparison should be made between a fixed-rate financing at then current interest rates and a variable-rate transaction, based on an appropriate floating rate index, as determined by the Director of the Division of Bond Finance. The cost of the variable-rate transaction should take into account all fees associated with the borrowing which would not typically be incurred in connection with fixed-rate bonds, such as tender agent, remarketing agent, or liquidity provider fees, for example.

b) *Limitation on variable-rate debt.* Rating agencies typically suggest limiting the amount of variable-rate debt to 15% to 20% of total outstanding debt. In keeping with that range, the total principal amount of variable-rate debt should not exceed 15% of total tax-supported debt outstanding at the time of the variable-rate debt issuance. In addition, the ratio of variable to fixed-rate tax-supported debt should be monitored by the Division of Bond Finance on a monthly basis; if the amount of variable-rate debt exceeds the 15% limit, appropriate officials in the Governor=s office should be notified to determine what, if any, actions should be taken to reduce the percentage.

c) *Budgetary controls*. To avoid a situation in which debt service on variable-rate bonds exceeds the annual amount budgeted, the following guidelines should be followed in establishing a variable-rate debt service budget:

i) A principal amortization schedule should be established, with provision made for payment of amortization installments in each respective annual budget.

ii) Provide for payment of interest for each budget year using an assumed budgetary interest rate which allows for fluctuations in interest rates on the bonds without exceeding the amount budgeted. The budgetary interest rate may be established by: (1) using an artificially high interest rate given current market conditions; (2) setting the rate based on the last twelve months actual rates of an appropriate index plus a cushion or spread to anticipate interest rate fluctuations during the budget year. The spread should be determined by considering the historical volatility of short-term interest rates, the dollar impact on the budget and current economic conditions and forecasts; or, (3) any other reasonable method determined by the Director of the Division of Bond Finance.

iii) The amount of debt service actually incurred in each budget year should be monitored monthly by the Division of Bond Finance to detect any significant deviations from the annual budgeted debt service. Any deviations which might lead to a budgetary problem should be communicated to appropriate officials in the Governor=s office to determine any appropriate action.

iv) As part of the efforts to monitor actual variable-rate debt service in relation to the budgeted amount the Division of Bond Finance should establish a system to monitor the performance of any service provider whose role it is to periodically reset the interest rates on the debt.

d) *Establish a hedge with Treasurer=s short-term investment pool*. The amount of variable-rate debt should not exceed one-third of the amount of the State=s short-term investments. This Ahedge@ mitigates the financial impact of debt service increases due to higher interest rates because, as debt service increases the State=s return on assets also increases. The Division of Bond Finance should monitor the hedge monthly, and if the one-third target is exceeded, appropriate officials in the Governor=s and Treasurer=s office should be notified to determine any appropriate action.

e) *Liquidity*. One of the features typical of variable-rate debt instruments is the bondholder=s right to require the issuer to repurchase the debt at various times and under certain conditions. This, in theory, could force the issuer to repurchase large amounts of its variable-rate debt on short notice, requiring access to large amounts of liquid assets. There are generally two methods for addressing this issue. Issuers who do not have large amounts of liquid assets may establish a liquidity facility with a financial institution which will provide the money needed to satisfy the repurchase. The liquidity agreement does not typically run for the life of long-term debt. Accordingly, there is a risk that the provider will not renew the agreement or that it could be renewed only at substantially higher cost. Similar issues may arise if the liquidity provider encounters credit problems or an event occurs which results in early termination of the liquidity arrangement; in either case, the issuer must arrange for a replacement liquidity facility. Issuers with significant resources, such as the State, may choose to provide their own liquidity. This approach eliminates the costs that would be charged by a third-party liquidity provider and could mitigate the renewal/replacement risk. Therefore, in order to avoid the costs and risks associated with liquidity provided by a financial institution, the preference should be for the State to provide its own liquidity.

Other Types of Financings

Refunding Bonds. Generally, the State issues refunding bonds to achieve debt service savings on its outstanding bonds by redeeming high interest rate debt with lower interest rate debt. Refunding bonds may also be issued to restructure debt or modify covenants contained in the bond documents. Current tax law limits to one time the issuance of tax-exempt advance refunding bonds to refinance bonds issued after 1986. There is no similar limitation for tax-exempt current refunding bonds. The following guidelines should apply to the issuance of refunding bonds, unless circumstances warrant a deviation therefrom:

a) refunding bonds should be structured to achieve level annual debt service savings;

b) the life of the refunding bonds should not exceed the remaining life of the bonds being refunded;

c) advance refunding bonds issued to achieve debt service savings should have a minimum target savings level measured on a present value basis equal to 5% of the par amount of the bonds being advance refunded; and,

d) refunding bonds which do not achieve debt service savings may be issued to restructure debt or provisions of bond documents only if such refunding serves a compelling State interest.

The 5% minimum target savings level for advance refundings should be used as a general guide to guard against prematurely using the one advance refunding opportunity for post-1986 bond issues. However, because of the numerous considerations involved in the sale of advance refunding bonds, the 5% target should not prohibit advance refundings when the circumstances justify a deviation from the guideline.

Certificates of Participation and Lease Type Financing. Under this type of financing, payments to holders of the securities are made from rental payments or other revenues which are subject to annual appropriation. The holders typically have no legal recourse against the State if it fails to make the necessary appropriation. Although this type of financing arrangement is not considered debt under a legal analysis, it is viewed as a financial obligation of the State and failure to make timely payments would damage the State=s reputation in the credit markets and increase the cost of future borrowings. Accordingly, the State may utilize this financing vehicle, but it should be considered as debt of the State and, absent compelling extraordinary circumstances, non-appropriation should not be considered.

Debt Issued With a Forward Delivery Date. Bonds may be issued that have a delivery date significantly later than that which is usual and customary. These bonds typically carry an interest rate penalty associated with the delay in delivery. There are also additional risks that delivery will not occur. Bonds with a forward delivery date may be issued if the advantages to the State outweigh the interest-rate penalty which will be incurred and the State is protected from adverse consequences of it being unable to fulfill its obligation to deliver bonds.

Swaps. When permitted by law, the State may enter into an interest-rate swap transaction where:

a) the risks to the State are identified and adequate provision is made to protect the State. Those risks include, but are not necessarily limited to, basis risk, liquidity risk, counterparty risk, and tax change risk;

b) there is an understanding of the consequences of terminating the swap and the conditions under which the State may pay or receive a payment in the event of termination; and,

c) the advantage to the State can be clearly demonstrated.

IV. METHOD OF SALE AND USE OF PROFESSIONALS

Generally

The administrative rules of the Division of Bond Finance shall be followed in determining the method of sale and engaging service providers.

Competitive Sale Preferred

The State should sell all debt through competitive sale unless there are legitimate business reasons for negotiation. In making the decision to sell through negotiated sale and in executing the sale, the State Bond Act and administrative rules of the Division of Bond Finance should be followed. Bonds may also be sold through a private or limited placement, but only if it is determined that a public offering, through either a competitive or negotiated sale, is not in the best interests of the State.

Allocation of Bonds

In the event a negotiated sale is determined to be in the best interests of the State, the Division of Bond Finance shall encourage syndicate rules which foster competition among the syndicate members and ensure that all members of the syndicate have an opportunity to receive a fair and proper allocation of bonds based upon their ability to sell the bonds.

Selection of Financing Professionals

Outside professionals may be used to the extent necessary to implement a financing. The State should seek to have minority-owned underwriting firm representation on its negotiated financings and should encourage underwriting syndicates to include minority underwriting firms in competitive sales.

All financing professionals should be selected through an independent evaluation of proposals submitted in response to a request for proposals. The administrative rules of the Division of Bond Finance should be followed regardless of whether those rules specifically apply to any particular financing. In addition to complying with the rules of the Division of Bond Finance, the following should be observed:

a) all proposals should be evaluated by a selection committee;

b) there is a strong preference that the selection committee be comprised of State employees from at least two separate State agencies;

c) there is a strong preference that each proposal should be evaluated independently by each selection committee member with no communication among grading committee members regarding the merits of the proposals; and,

d) in connection with the request for proposals for underwriters, all financial institutions, including foreign financial institutions, shall certify that they have policies and procedures to ensure that:

i) they are not conducting, facilitating or engaging in any investment activities in Iran, as described in 22 U.S.C. § 8532; and,

ii) they are not conducting, facilitating or engaging in prohibited transactions with Sudan, as described in 31 C.F.R. 538.

V. DISCLOSURE

Primary Disclosure

To the greatest extent practicable, the following should be observed:

a) disclosure recommendations of the Government Finance Officers Association should be followed, specifically including the recommendation that financial statements be prepared and presented according to generally accepted accounting principles; and

b) in addition to making available the preliminary and final official statements in printed form, the Division of Bond Finance should also make the official statements available on its internet web site.

Continuing Disclosure

To the greatest extent practicable, the following should be observed:

a) the Division of Bond Finance will assist all agencies of the State for which it issues bonds in complying with continuing disclosure requirements; and,

b) the Division of Bond Finance may make available on its internet web site such information as the Director of the Division of Bond Finance determines to be relevant to investors.

VI. POST-ISSUANCE CONSIDERATIONS

Investment of Bond Proceeds

Construction Funds. All construction funds received from the sale of bonds should be invested with the State Treasurer in accordance with the bond documents and consistent with the Treasurer=s practices on investing, unless otherwise required by law.

Sinking and Escrow Funds. All funds held for the payment of debt service should be invested by the State Board of Administration in accordance with the bond documents and consistent with the State Board of Administration=s practices on investing, unless otherwise required by law.

Arbitrage Compliance

The Division of Bond Finance is statutorily responsible for ensuring that all tax-exempt bonds it issues remain in compliance with the federal arbitrage regulations. In carrying out these responsibilities, the Division should monitor and analyze the investment and use of bond proceeds and calculate arbitrage rebate liabilities. Arbitrage rebate liabilities should be calculated and funded annually. The Division should discharge its statutory responsibility for arbitrage rebate to protect the tax-exempt status of interest on the State's bonds.