COUNTY OF SAN DIEGO
DEBT ADVISORY COMMITTEE

REFUNDING POLICY

INTRODUCTION

Pursuant to the County of San Diego ("County") Board of Supervisors Policy B-65, which states that the County shall continually review outstanding obligations and aggressively initiate refinancings when economically feasible and advantageous, this Refunding Policy ("Policy") of the County establishes minimum guidelines for the County's use of current, taxable advance, forward and synthetic refinancings, also referred to as refundings. This Policy supports the Operational Excellence Strategic Initiative in the County's Strategic Plan by providing guidelines for the Debt Advisory Committee ("DAC") to consider when developing a recommendation that the County should pursue a refunding transaction, but does not obligate the County to proceed in every case that the minimum guidelines are met. The DAC shall have the flexibility to exercise discretion in waiving these guidelines. Additionally, the DAC may impose stricter standards for specific transactions that may pose a greater level of risk to the County.

The DAC shall review this Policy annually. Each year, the Debt Finance Manager shall review the Policy with the County's Municipal Advisor (MA) to determine if any changes to the Policy are needed. Subsequent to review with the MA, the Debt Finance Manager shall send the Policy with any proposed changes, if applicable, to DAC members and supporting staff for additional input. The DAC shall approve any changes by the end of the calendar year and the changes will become effective upon approval.

OBJECTIVES

The primary objective of proceeding with a refunding shall be to benefit the County by:

- Providing net present value debt service savings, and/or
- Eliminating burdensome or restrictive covenants imposed by the terms of the bonds to be refunded, and/or
- Changing the type of debt instrument, and/or
- Reducing or mitigating risks, and/or

- Restructuring the County's overall debt service portfolio.

MINIMUM GUIDELINES

The County may consider different financing structures for refunding issues that typically meet the following guidelines:

- Refunding issues should generate net present value savings (as outlined in the next section.)
- The final maturity of the refunding bonds should be no longer than the final maturity on the refunded bonds.
- Refunding issues should be structured to achieve level annual debt service savings or to level out overall debt service of the total portfolio or of a specific debt type for budgeting certainty.
- Refunding issues should generate a minimum of $1 million total net present value savings and $100,000 of average savings on an annual basis.
- Small potential refundings that do not meet the minimum savings guidelines as described above, on a stand-alone basis, can be considered if they can be added to a larger refunding that meets the minimum savings requirements.

Meeting one or more of the minimum guidelines will not necessarily result in the County executing a refunding issue. All costs and benefits of the refunding will be taken into account by the DAC in determining if the refunding is in the best interest of the County.

PRESENT VALUE SAVINGS CALCULATION

A present value analysis should be prepared to identify the economic effect of any proposed refunding. To proceed with a refunding, a minimum net present value savings amount, as a percentage of the refunded par amount, should be achieved. A guideline of appropriate saving thresholds for the different refunding alternatives, based on the level of risk they pose to the County, are presented below. The savings shall be calculated net of all issuance fees and using a net debt service savings approach, which takes into consideration arbitrage rebate requirements.

- *Current Refunding*: A minimum of 3% net present value savings should generally be achieved.
- *Advance Refunding*: Following the elimination of tax-exempt advance refundings in the Tax Reform and Jobs Act of 2017 ("TRJA"), only current refundings can be executed on a tax-exempt basis. However, under certain circumstances, the County can consider a taxable advance refunding if i) it is considered necessary to restructure a portion of the County's debt portfolio or ii) a minimum of 5% net present value savings can be achieved. Prudent analysis should be performed to compare waiting until the call date

versus executing a taxable advance refunding. In addition, a prudent analysis should be done to determine the most efficient method of funding the escrow portfolio.

- *Forward Refunding*: A minimum of 4% net present value savings should generally be achieved, the County should consider any additional risks in the bond purchase contract and a prudent analysis should be performed to compare waiting until the call date versus executing a forward refunding.
- *Synthetic Refunding*: A minimum of an additional 2% net present value savings over the applicable savings levels, as outlined above, should generally be achieved.

Because the level of risk will vary depending on the specific structure of the transaction and market conditions at the time of issuance, the DAC has the discretion to prescribe higher levels of target savings to optimize the County's financial objectives.

GUIDING PRINCIPLES

In evaluating refunding opportunities and applying the above referenced guidelines, the DAC and staff shall also consider the following:

- Tax-exempt refundings of tax-exempt bonds should be considered the standard refunding approach.
- Taxable refundings should only be considered under special circumstances, such as a restructuring for financial flexibility or significant savings levels. For taxable advance refundings, adjustments to savings thresholds may be justified based on where interest rates are at the time of the refunding relative to historical markets. In low interest rate markets a lower threshold may be justified while a higher threshold would be justified in high interest rate markets.
- The couponing and/or callability of the refunding bonds may also justify adjustments to the savings threshold. Low coupon bonds may warrant a lower savings threshold as the ability to generate significant savings may be limited. Bonds that have reached their call date may also warrant a lower savings threshold as continuing to wait to call the bonds will result in foregone savings.

RELATED DEFINITIONS

Advance Refunding
Refunding bonds issued more than 90 days before the call date of the bonds being refunded. Prior to the TRJA, which eliminated tax-exempt advance refundings, issuers could advance refund a series of bonds on a tax-exempt basis once over the life of the bond series. Following TRJA, issuers cannot advance refund bonds with tax-exempt refunding bonds, but there are no such limitations

with the issuance of taxable advance refunding bonds; however, taxable interest rates are more costly than tax-exempt interest rates.

Aggregate Present Value Savings
The Present Value Savings in each year of the refunding transaction added together.

Current Refunding
Refunding bonds issued 90 days or less before the call date of the bonds being refunded.

Forward Refunding
A refunding in which the bonds are sold with the intent to close or deliver at some future point in time, generally at least more than 4 weeks after pricing (depending on market conditions), and often to coincide with a date within 90 days prior to the call date on the refunded bonds, thereby qualifying as a Current Refunding.

Net Debt Service Savings Approach
A method to calculate refunding savings that accounts for the difference in interest earnings of the debt service reserve funds of the refunded and refunding bonds.

Net Present Value Savings
A method of calculating the aggregate amount of savings on a refunding transaction taking into consideration the time value of money and net of all issuance fees and any contributed non-bond proceeds.

Present Value Savings
In each semi-annual period, the present value of the debt service on the refunding bonds is subtracted from the present value of the debt service on the refunded bonds using the arbitrage yield on the refunding bonds as the discount rate.

Synthetic Refunding
Includes more complex, alternative refunding instruments such as interest rates swaps, derivatives, and hedges (including interest rate swaptions, caps, floors, and collars).

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Approved by the Debt Advisory Committee on July 25, 2007
Last amended and approved by the Debt Advisory Committee on ***April 28, 2021***