City of Philadelphia
Debt Management Policy
August 2008

I. INTRODUCTION

While the issuance of debt is often an appropriate method of financing capital projects and major equipment acquisition, it needs to be monitored to maintain financial integrity, flexibility, and credit strength. The City of Philadelphia (the City) recognizes that the foundation of a well-managed debt program is a comprehensive debt management policy. This policy will address appropriate ways to structure debt issuances, prudent uses for different types of debt financings, and guidelines for bond sales.

The debt program managed by the City includes general obligation debt, tax-supported lease and contract debt issued by related authorities, debt of the Water and Sewer and Aviation Departments, and debt of the Philadelphia Gas Works (PGW). Debt of the Pennsylvania Intergovernmental Cooperation Authority (PICA), School District of Philadelphia (SDP), and the Philadelphia Parking Authority (PPA) is managed independently. While the guidelines contained within relate mainly to the City's issuance of tax-supported debt, there is applicability to revenue bond issuance as well.

The Director of Finance has overall responsibility for debt issuance. Day-to-day debt management is the responsibility of the City Treasurer, and the Executive Director of the Sinking Fund Commission is responsible for making debt service payments. The Office of the City Treasurer and the City Solicitor's Office coordinate their activities to ensure that all debt is issued in compliance with federal, state, and local laws.

II. OBJECTIVES

The City's general obligation bond ratings are currently Baa1/BBB/BBB+ by Moody's, S&P, and Fitch, respectively. These credit ratings are below average for a major municipality and consequently, the City pays a higher interest rate on amounts borrowed. It is the goal of the City to improve its bond ratings to the 'A' category which would result in lower interest costs and a reduced burden on the City's General Fund. This policy will assist the City in this goal through the maintenance of sound debt practices. In addition, this policy will set forth appropriate guidelines for bond sales.

The Office of the City Treasurer will use these policies to determine appropriate uses of debt, parameters for debt issuance, and the method of bond sale. This policy will be used in conjunction with the City's Swap Policy which is currently under development and is expected to be completed by November 2008. In addition, this policy will be reviewed annually and updated as needed.

III. TYPES OF LONG TERM DEBT

General Obligation Debt

The City can issue general obligation debt, backed by the full faith, credit and taxing power of the City, subject to voter approval and subject to adherence to the Commonwealth Constitution. The Constitution limits the amount of the City's outstanding general obligation debt to 13.5% of the immediately preceding 10-year average of assessed value of taxable real property, with debt greater than 3% of the immediately preceding 10-year average of assessed value of taxable real property having to get voter approval. This limitation does not include self-supporting general obligation bonds, which are defined as general obligation debt incurred for revenue producing facilities which are expected to produce excess revenues sufficient to cover debt service on the bonds. Because (i) assessed value is about 30% of full taxable value of property in the City, (ii) full taxable values are only a portion of actual sales values, and (iii) property taxes are not one of the largest sources of revenue, this Constitutional limitation does not provide a meaningful restriction. The City is contemplating changing its tax assessment system to ensure that assessed values fully reflect actual values, which would be done in conjunction with a reduction in the millage rate. This change would provide added flexibility under the Commonwealth Constitution to issue general obligation bonds.

Contract and Lease Debt

In addition to general obligation debt, the City issues tax-supported obligations through the use of its related authorities. Debt issued by related authorities is repaid through lease or contract agreements whereby annual rental payments from the City's general fund to the related authorities are sufficient to cover debt service. In this debt structure, the City covenants to budget and appropriate each fiscal year for rental payments and the City's obligation to make rental payments is unconditional. Because of this, both Moody's and S&P view the City's lease debt with the same credit strength as the general obligation bonds and have assigned the same credit ratings to both.

The various authorities that are available to issue general fund supported debt are: Philadelphia Authority for Industrial Development (PAID), The Philadelphia Municipal Authority (PMA), and the Redevelopment Authority of the City of Philadelphia (RDA). In addition to general fund supported debt, some city enterprise funds such as the Aviation Department have occasionally issued debt through the City's related authorities.

Revenue Bonds

The City Treasurer also oversees the issuance of revenue bonds for the Water and Sewer Department, the Aviation Department, and PGW. The Airport Revenue Bonds are rated A2/A+/A by Moody's, S&P, and Fitch, respectively. The Water and Wastewater Revenue Bonds are rated A3/A-/A- and the Gas Works Revenue Bonds are rated Baa2/BBB-/BBB- by Moody's, S&P, and Fitch, respectively. These revenue bonds are not included in the City's calculations in Section V. General Fund Fixed Cost Affordability because they are paid from non-general fund revenue sources.

IV. GENERAL PRINCIPLES FOR DEBT ISSUANCE

General guidelines which the City intends to follow are:

- Debt to fund capital projects should only be issued if the capital projects are authorized and included in the City's six-year Capital Program.

- The average life of debt should be no greater than the projected average life of the assets being financed and the final maturity should be limited to 30 years.

- Principal should generally be amortized to achieve approximately level debt service; however, principal repayment can be structured to result in more rapid amortization (front-loaded debt service). In addition, the repayment structure from prior bond issues may warrant consideration when structuring principal and interest payments. An example of this is the series 1999 pension obligation bonds which were structured with a substantially higher debt service payment in fiscal 2029. The administration should take this into consideration when structuring future debt to minimize adding to the already high debt service burden in fiscal 2029.

- For tax supported debt, principal amortization should generally be structured to reach a target of 50% of all outstanding principal scheduled to be repaid within 10 years. This provides increased financial flexibility and debt capacity in future years. However, consideration for a longer scheduled principal repayment percentage should be given if asset life is significantly longer than 30 years.

- Long-term debt obligations should generally be callable in no later than 10 years. This provides flexibility to refund bonds if interest rates decline.

- Debt should generally be limited to serial and term maturities but can be sold in the form of capital appreciation bonds (CABs) or other forms if market conditions warrant. Interest on a capital appreciation bond is compounded over time and paid at maturity. Because of this, interest payments are delayed until future years which can constrain future financial flexibility. However, it may be advisable to issue CABs if market demand is strong for CABs and overall debt service for the bond issue is still level.

- Any premium above par received from the sale of bonds should be used to pay the costs of issuance or be deposited into the Sinking Fund Account for payment of debt service.

- The City will aim to fund a portion of routine capital projects in each year's capital program with pay-as-you-go financing.

V. GENERAL FUND FIXED COST AFFORDABILITY

In order for the City to maintain a balance between fixed costs and available resources, certain self-imposed limitations should be set. These limitations will be reviewed annually to determine continued applicability and appropriateness.

The ratios that are the most applicable to monitor the City's debt levels relate to debt service and other fixed costs as a percentage of budget. The City looks at fixed costs as a percentage of the general fund budget because it is a good measure of financial flexibility. The higher the fixed costs as a percentage of budget, the less financial flexibility the City has. It is important to note that debt as a percentage of market value is less applicable to the City than it is to other municipalities because of the relatively low percentage of the City's revenues derived from property taxes. For this reason, a ratio of debt to market value is not considered an appropriate target for the City's debt policy.

The largest fixed cost in the City's general fund budget is the payment to amortize the City's unfunded pension liability. The City is currently paying the Minimum Municipal Obligation (MMO) annually which is the lowest amount that the City is statutorily allowed to fund. Like with debt service, there is no flexibility to lower this payment.

The first ratio that the City uses to monitor its debt levels is:

Description	**Target**
Tax Supported Debt Service plus Long Term Obligations as a percentage of General Fund and Debt Service Fund Expenditures.	15% maximum

Tax Supported Debt Service is defined as debt service on general obligation bonds and other tax-supported debt less any self-supporting general obligation debt. For purposes of this calculation and the calculation of the ratios below, it includes PICA debt service. Long Term Obligations include the MMO (excluding Normal Costs), amounts payable by the City under the Convention Center Operating Agreement between the City, the State, and the Pennsylvania Convention Center Authority once the agreement has been signed ($15 million to $17.5 million annually), and other fixed costs such as the Eagles Stadium Operating and Expense Reimbursement ($7 million to $12 million annually).

In fiscal 2008, this ratio was an estimated 15.9%. The 15% limit reflects the City's desire to reduce the percentage of its budget which is fixed in future years to assist with financial flexibility.

In addition to the above ratio, it is useful to look at the City's debt service costs as a percentage of general governmental expenses as this ratio can easily be compared to the same ratio of municipalities across the country. The credit rating agencies often cite this ratio in their reports and analysis. The ratio is as follows:

Description	Target
Tax Supported Debt Service as a percentage of General Fund and Debt Service Fund Expenditures.	15% maximum

This ratio is then looked at without pension obligation debt service because by issuing pension obligation bonds, the City is substituting one fixed liability (pension costs) for another (debt service).

Description	Target
Tax Supported Debt Service excluding Pension Obligation Bond Debt Service as a percentage of General Fund and Debt Service Fund Expenditures.	10% maximum

According to Moody's, debt service as a percentage of expenditures frequently ranges from 5% to 15%,[1] S&P states that 8% to 15% represents a moderate debt burden[2] , and Fitch Ratings states that debt service above 10% of budget for cities and counties can create budgetary competition.[3] In fiscal 2008, the debt service ratio including pension obligation debt service was an estimated 8.6% and excluding pension obligation debt service was an estimated 6.6%. See the Appendix for the listing of debt ratio targets compared with actual performance for fiscal 2008. It is the City's goal to keep the debt ratios under the listed maximum targets while maintaining the General Principles listed on page three.

VI. REFINANCING OUTSTANDING DEBT

Refunding opportunities should be monitored on an ongoing basis to evaluate potential savings. A present value analysis should be prepared to analyze the potential savings and all costs of the refinancing should be taken into account. The present value analysis should be calculated on the transaction as a whole and on a maturity-by-maturity basis. To proceed with the refinancing, the present value savings should be at least three percent of the principal amount of the refunded debt incorporating all costs of issuance. For each maturity being refunded, the present value savings should be at least one percent. If variable rate bonds are being issued with an associated swap, the present value savings should be at least five percent of the principal amount of the refunded debt to account for the additional interest rate and credit risk associated with these transactions.

For variable rate bonds, a present value savings cannot be reliably computed since interest rate pricing varies from week to week. However, the City should analyze the estimated savings from a refunding of variable rate debt based on historical interest rates to determine whether to proceed.

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[1] Moody's report titled "Moody's Approach to Analyzing Municipal Long-Term Debt" dated February 2004

[2] S&P report titled "Public Finance Criteria: Key General Obligation Ratio Credit Ranges – Analysis vs. Reality" dated April 17, 2008.

[3] Fitch Ratings report titled "Local Government General Obligation Rating Guidelines" dated March 22, 2007

Some refundings may take place for reasons other than for present value savings in which case these refundings do not need to meet the savings test. Reasons for issuing refunding bonds other than present value savings could be to restructure debt or to change bond covenants contained in an indenture. For all refunding bonds, maturities should not extend beyond the final maturity of the refunded bonds and savings should be taken on a level basis for the life of the debt.

Current Refundings
For current refundings, the refunding escrow may not exceed 90 days.

Advance Refundings
For advance refundings, the refunding escrow exceeds 90 days. Because municipal tax-exempt bonds issued after 1985 cannot be advance refunded more than once, the City should carefully consider the benefits and opportunity costs of moving forward on an advance refunding.

VII. VARIABLE RATE AND SHORT TERM DEBT

Variable rate debt can be used for several purposes, including achieving a lower cost of borrowing by accepting a degree of interest rate risk, offsetting the risks associated with variable rate short term assets, or for short-term financing needs. Variable rate debt most often can be redeemed on short notice without penalty so the use of variable rate debt increases financing flexibility if a debt prepayment is expected. In addition, variable rate debt can act as a hedge to short term cash investments.

Criteria for Use of Variable Rate Debt
Variable rate debt must be managed prudently as the City needs to have the financial wherewithal to handle the fluctuations in interest rates which occur over time. Because of this, the proportional amount of unhedged variable rate debt to total debt should be limited.

Description	**Target**
Amount of Unhedged Variable Rate Debt as a percentage of Total Debt.	20% maximum

This limitation should be calculated separately for general fund supported debt, Airport Revenue Bonds, Water and Wastewater Revenue Bonds, and Gas Works Revenue Bonds. Unhedged debt refers to debt not hedged through the use of interest rate swaps.

When deciding whether to issue variable rate debt, historic averages of cash balances should be evaluated to confirm that the financial flexibility is available if interest rates rise. In addition, for any contemplation of synthetic variable rate debt, provisions set forth in the City’s Swap Policy should be adhered to.

Main Types of Short Term Debt

- Tax and Revenue Anticipation Notes (TRANs) – TRANs are short term notes secured by a pledge of taxes and other general fund revenues. The City has issued TRANs annually since 1972 (with a single exception) to manage the timing mismatch between general fund revenues and expenditures during the year. TRANs in recent years have generally been sized between 5% and 10% of anticipated general fund receipts. TRANs must be repaid in full by the end of the fiscal year in which they are issued.

- Commercial Paper (CP) – CP has maturities of up to 270 days and is commonly used to finance project construction. It can be issued incrementally as funds are needed and then refunded with a long-term financing once the project is completed to take advantage of lower short-term rates. PGW issues CP for the financing of working capital related to receivables, another typical use of a CP program.

- Bond Anticipation Notes (BANs) – BANs are short term obligations, repayment of which is backed by proceeds of an upcoming authorized bond issue.

VIII. BOND SALE GUIDELINES

Selection of Bond Professionals

In selecting bond professionals, including financial advisor and bond counsel services, the City and its related agencies must comply with Chapter 17-1400 of the Philadelphia Code, the City's Contract Reform Legislation. This sets forth provisions regulating the process by which the City awards professional service contracts and other non-competitively bid contracts. While the Contract Reform Legislation is not applicable to the selection of bond underwriters, the City will choose underwriters for a negotiated sale through a Request for Qualifications (RFQ) process similar to that for bond professionals covered under the Contract Reform Legislation except for in emergency situations.

Method of Sale – Competitive v. Negotiated

There are two methods of issuing bonds, a competitive sale and a negotiated sale. In a competitive sale, underwriters submit sealed bids and the sale is awarded to the underwriter syndicate with the lowest all-in True Interest Cost (TIC). In a negotiated sale, the underwriter(s) are chosen through a RFQ process and the interest rate and underwriter's fees are negotiated prior to sale.

Each proposed sale of bonds should be evaluated to determine if it is in the City's best interest to issue the bonds by competitive or negotiated sale. Competitive sales usually result in lower costs of borrowing to municipal borrowers; however certain factors might make a negotiated sale result in a lower cost of borrowing. The factors to be considered include the following:

- Volatility of market conditions: It is generally thought that during volatile market conditions, it is best to issue bonds by negotiated sale so that the underwriters can help determine the timing of the bond sale.

- Size of the bond deal: The bond size is an important determinant of market demand. Transactions that are very big or very small might benefit from a negotiated sale's increased marketing efforts. A small bond transaction might not attract enough market attention without a sales effort while the market might have a difficult time absorbing a large bond deal without pre-sale activity.

- Source of security for the bonds: Bond transactions with complex or new types of securities might benefit from a negotiated sale as the market is often reluctant to accept new innovations. New types of debt instruments might require an education process that lends itself better to a negotiated process. As the market becomes more familiar with a certain type of debt instrument, the need for a negotiated sale for this reason diminishes.

- Credit Strength: Issuers with higher credit ratings might fare better in competitive bidding than those with credit ratings on the weaker end of the spectrum due to the demand for high rated municipal paper. Lower rated bonds can benefit from the sales effort that comes with a negotiated sale. However, if a lower rated borrower comes to the market frequently, the need for a negotiated sale for this reason diminishes because the market is more familiar with the credit.

- Syndicate Composition: A competitive sale does not provide the City with influence over choosing the underwriting syndicate. If influencing the composition of the syndicate to obtain disadvantaged business participation is important, then a negotiated sale might be the best method. If a negotiated sale is chosen for this reason, the criteria and rationale for selection should be clearly stated to avoid appearances of favoritism.

Allocation of Bonds

The book-running senior manager is responsible for ensuring that the overall allocation of bonds meets the City's goals of obtaining the best price for the issue and providing firms with allocations that are commensurate with work performed. The City reviews and approves bond allocations prior to their release. The most common priority for assigning orders is:

- Retail orders, especially those from Pennsylvania, should be given first priority.
- Net designated institutional orders should be given second priority.
- Group net orders and member orders should be given the lowest priority.

IX. INVESTOR AND RATING AGENCY COMMUNICATION

Continuing Disclosure

The City will comply with Securities and Exchange Commission (SEC) Rule 15c2-12 which requires an annual filing with each Nationally Recognized Municipal Securities Information Repository and State Repository that provides financial information and operating data relevant to investors in City and related authority obligations. The City files its Comprehensive Annual Financial Report, the Annual Report of Bonded Indebtedness, the Airport Department's Annual Report, the Water and Sewer Department's Annual Report, and PGW's Annual Report. In addition, it files when material events occur.

The City is currently contracted with an outside firm, Digital Assurance Certification (DAC), to provide dissemination services to the City with respect to General Obligation Bonds, Airport Revenue Bonds, Gas Works Revenue Bonds, Water and Wastewater Revenue Bonds, and certain City-related lease debt.

Rating Agency Communication

The City will make every reasonable effort to maintain and improve its bond ratings. To this goal, the City should keep a line of communications open with the rating agencies, informing them of major financial events in a timely manner. All communications should be made by the Finance Director or the City Treasurer or individuals they specifically designate. In addition to phone calls updating the rating agencies on financial events, in-person meetings should be scheduled at least once a year or more often as conditions warrant.

X. OTHER

Arbitrage Requirements

The City will comply with all of its tax certificates for tax-exempt financings by monitoring the arbitrage earnings on bond proceeds on an interim basis and by rebating all positive arbitrage when due, pursuant to Internal Revenue Code Section 148. The City currently employs an arbitrage consultant to prepare these calculations.

Appendix - Debt Ratios

Ratio #1	Goal	Fiscal 2008 Estimate
Tax Supported Debt Service plus Long Term Obligations as a percentage of General Fund and Debt Service Fund Expenditures.	15.0%	15.9%

Ratio #2		
Tax Supported Debt Service as a percentage of General Fund and Debt Service Fund Expenditures.	15.0%	8.6%

Ratio #3		
Tax Supported Debt Service excluding Pension Obligation Bond Debt Service as a percentage of General Fund and Debt Service Fund Expenditures.	10.0%	6.6%