

CITY OF PEARLAND, TEXAS
COMPREHENSIVE FINANCIAL MANAGEMENT POLICY STATEMENTS

ADOPTED
SEPTEMBER 2011

Purpose

The Comprehensive Financial Management Policy Statements assembles all of the City's financial policies into one document. These statements are the tools used to ensure that the City is financially able to meet its current and future service needs. The individual statements contained herein serve as guidelines for both the financial planning and internal financial management of the City.

Municipal resources must be wisely used to ensure adequate funding for the services, public facilities, and infrastructure necessary to meet immediate and long-term needs. These policy statements safeguard the fiscal stability required to achieve the City's objectives and ensure long-term financial health.

Objectives

- A. To guide City Council and management policy decisions that have significant fiscal impact.
- B. To employ balanced revenue policies that provide adequate funding for services and service levels.
- C. To maintain appropriate financial capacity for present and future needs.
- D. To maintain sufficient reserves so as to maintain service levels during periods of economic downturn.
- E. To promote sound financial management by providing accurate and timely information on the City's financial condition.
- F. To protect the City's credit rating and provide for adequate resources to meet the provisions of the City's debt obligations on all municipal debt.
- G. To ensure the legal use of financial resources through an effective system of internal controls.
- H. To promote cooperation and coordination with other governments and the private sector in financing and delivery of services.

I.
ACCOUNTING, AUDITING, AND FINANCIAL REPORTING

Maintain accounting practices that conform to Generally Accepted Accounting Principles (GAAP) and comply with prevailing federal, state, and local statutes and regulations. Provide for, prepare and present regular reports that analyze and evaluate the City's financial performance and economic condition.

A. *Accounting Practices and Principles*

The City will maintain accounting practices that conform to Generally Accepted Accounting Principles (GAAP) as set forth by the Governmental Accounting Standards Board (GASB), the authoritative standard setting body for units of local government. All City financial documents, except monthly interim financial reports, including official statements accompanying debt issues, Comprehensive Annual Financial Reports and continuing disclosures statements will meet these standards. Monthly interim financial reports are on a cash basis and will be reported as budgeted. At year-end, the general ledger and financials will be converted to GAAP and GASB.

B. *Financial and Management Reporting*

1. Interim Financial Reports will be provided monthly to management and City Council that explain key economic and fiscal developments and note significant deviations from the budget. These reports will be distributed monthly by the end of each month for the prior month.
2. Quarterly, departments will report on program measures and indicators as compared to target and last year to Finance. A quarterly report will be submitted to the City Manager, highlighting significant variations.
3. As an additional independent confirmation of the quality of the City's financial reporting, the City will annually seek to obtain the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting.

C. *Annual Audit*

1. Pursuant to State Statute, the City shall have its records and accounts audited annually and shall have an annual financial statement prepared based on the audit. The audit shall be performed by certified public accounting (CPA) firm, licensed to practice in the State of Texas. The annual financial statement, including the auditor's opinion, shall be filed within 180 days after the last day of the City's fiscal year. The audit firm shall also provide a Single Audit of Federal and State grants, when necessary. An official Comprehensive Annual Financial Report (CAFR) shall be issued no later than six (6) months following the end of the fiscal year. The Director of Finance shall be responsible for establishing a process to ensure timely resolution of audit recommendations.
2. *Audit Committee*
The Mayor shall appoint or confirm the audit committee, consisting of at least three members of the City Council, with the Mayor being one of the members. The primary purpose of the audit committee is to assist City Council and the City Manager in fulfilling oversight responsibilities for financial reporting, audit processes, and effective internal control systems. The City shall maintain an Audit Committee Charter which outlines the duties and responsibilities of the audit committee.
3. *Annual Financial Disclosure*
As required by the Securities and Exchange Commission (SEC) Rule 15c2-12, the City will provide certain annual financial information to various information repositories through disclosure documents or set of documents that include the necessary information. This will include any periodic materials event notices as required by the SEC.

D. *Signature of Checks*

Pursuant to the City Charter, all checks shall have two signatures, signed by the City Manager or Mayor and countersigned by the City Secretary, or the City Treasurer, or one member of Council. City Treasurer is further defined as the Director of Finance. Signatures shall be affixed on all City checks via facsimile signatures, either with a signature plate used with a check signing machine or with a secure laser check printing system. Component unit check signers are officers elected by the board, where applicable. Component unit's checks shall also have two signatures.

E. *Compliance with Council Policy Statements*

The Financial Management Policy Statements will be reviewed bi-annually and updated, revised or refined as deemed necessary. Policy statements adopted by City Council are guidelines, and occasionally exceptions may be appropriate and required. Exceptions will be identified, documented, and explained to City Council and/or the City Manager.

II.
BUDGET AND LONG RANGE FINANCIAL PLANNING

A. *Balanced Budget*

The City Manager shall file annually, a structurally balanced budget for the ensuing fiscal year with City Council pursuant to the prevailing state and local law. A structurally balanced budget is further defined as recurring revenues funding recurring expenditures and adherence to fund balance policies. Short-term loans will be avoided as budget balancing techniques.

B. *Current Funding Basis (Recurring Revenues)*

The City shall budget and operate on a current funding basis. Recurring expenditures shall be budgeted and controlled so as not to exceed current revenues. Recurring expenses will be funded exclusively with recurring revenue sources to facilitate operations on a current funding basis.

C. *Use of Non-Recurring Revenues*

Non-recurring revenue sources, such as a one-time revenue remittance of fund balance in excess of policy can only be budgeted/used to fund non-recurring expenditures, such as capital purchases or capital improvement projects. This will ensure that recurring expenditures are not funded by non-recurring sources.

D. *Tax Rate*

The City Manager will recommend a tax rate that the City finances require in order to operate efficiently, yet effectively, and pay its debt.

1. *Homestead Exemption*

The City shall review the homestead exemption annually as part of the budget process. When the financial health of the City's finances and economic and market conditions of the local economy justify, the City Manager may recommend a change to the homestead exemption. In accordance with state statute, any recommended change in the homestead exemption will be presented to Council for approval prior to July 1. The total exemption percentage granted shall not exceed the state statute limitation.

2. *Over-Age and Disabled Persons Exemptions*

The City currently grants a \$40,000 exemption for persons 65 or older and for disabled persons. This amount shall remain stable during a period in which the City is considering increasing the homestead exemption.

E. *Pay As You Go Capital Projects*

The transfer from the City's General Fund and the City's Utility Fund to fund pay-as-you-go capital projects will be budgeted when financially feasible and when projects present themselves for funding. The transfer will be based on the financial health of each fund with the long-term goal of adequately funding rehabilitation.

F. *Revenue Estimating for Budgeting*

1. In order to protect the City from revenue shortfalls and to maintain a stable level of service, the City shall use a conservative, objective, reasonable and analytical approach when preparing revenue estimates. The process shall include historical collection rates, trends, development, and probable economic changes. This approach is intended to reduce the likelihood of actual revenues falling short of budget estimates and should avoid mid-year service charges.
2. The City whenever possible, will seek outside sources of revenue, such as federal, state, and local grants, in order to leverage local dollars.
3. Estimates from grant sources will be projected only to the specific date on which the entitlement will end.
4. The Utility Fund water and wastewater revenues will be budgeted based on the average rainfall/consumption over the last three years, pursuant to the rate model. The City will anticipate neither drought nor wet conditions.

G. *Performance, Merit Pool, and Police Step Increases*

The budget shall include an amount adequate to cover an overall average performance and merit pool, as well as an amount for police step increases, as determined annually by the City Manager. This amount will be calculated for each fund, based on budgeted salaries for the year, and will be placed in a Performance and Merit Pool in each operating fund. In addition, funds may be budgeted when appropriate, to bring identified jobs up to market salary rates.

H. *Budget Preparation*

1. Department Directors have primary responsibility for formulating budget proposals. New or expanded services should support City Council goals, City Manager priority direction and department goals. Departments are charged with implementing them once they are approved.
2. All competing requests for City resources will be weighted within the formal annual budget process.
3. Actions on items that come up throughout the year with significant financial impacts should be withheld until they can be made in the full context of the annual budget process and long-range plan, unless unforeseen circumstances present themselves.
4. Every five (5) years at a minimum or sooner as may be necessary, the city will incorporate a service needs review into the budget process to ensure the most efficient and effective use of resources.
5. Annually, the City will seek to obtain the Government Finance Officers Associate Distinguished Budget Presentation Award. The Budget will be presented in a way that not only meets the criteria of the award, but also clearly communicates the budget to the public.

I. *Budget Management*

The City Council shall delegate authority to the City Manager in managing the budget after it is formally adopted by the City Council, including the transfer of funds within departments, between divisions, and between departments. The City Manager may further delegate levels of authority for the daily operations of the budget. Expenditures/expenses are legally adopted by the fund level. Expenditures/expenses should not exceed the adopted budget, plus subsequent changes approved by the City Council.

J. *Amended Budget*

In order to preserve fund balances/ending balances based on projected revenues and expenditures/expenses for the current fiscal year, City Council will amend the annual budget for all funds, excluding capital improvements funds, as set forth in the projections. City Council will amend the current fiscal year budget annually during the budget process.

K. *Performance Measurement*

Performance measures will be utilized and reported in department budgets. The City will maintain a measurement system that reports trends and comparisons to targets and previous year as a management tool to monitor and improve service delivery.

L. *Operating Deficits*

The City shall take immediate corrective action if at any time during the fiscal year expenditure and revenue re-estimates are such that "net income" is lower than budgeted. Corrective actions include:

- Deferral of capital equipment purchases
- Deferral of pay-as-you go capital improvements
- Expenditure reductions
- Deferral of certain positions
- Hiring freezes
- Freeze merit increases
- Use of fund balance
- Use of volunteers
- Increase fees
- Reduce work hours with subsequent reduction in pay
- Eliminate positions which may require laying-off employees if there are no other vacant positions for which they are qualified.

Short-term loans as a means to balance the budget shall be avoided.

The use of fund balance, which is a one-time revenue source, may be used to fund an annual operating deficit, only with a subsequent approval of a plan to replenish the fund balance if it is brought down below policy level.

M. *Long-Range Financial Plans*

1. The City shall develop and maintain a five-year Financial Forecast for each major operating fund, in conjunction with the annual budget process. Major operating funds are as follows:
 - General Fund
 - Debt Service Fund
 - Water/Sewer Utility Fund
 - Economic Development Corporation
2. The forecast should enable current services and current service levels provided to be sustained over the forecast period. Operating impacts from completed capital improvement projects in the City's five-Year CIP shall be included in the forecast. Commitments/obligations already made that require future financial resources shall also be included.
3. The forecasts should identify impact to property taxes and utility rates.
4. Major financial decisions should be made in the context of the Long-Range Plan.

The forecast assesses long-term financial implications of current and proposed policies, programs, and assumptions that develop appropriate strategies to achieve the City's goals. The forecast will provide an understanding of available funding; evaluate financial risk; assess the likelihood that services can be sustained; assess the level at which capital investment can be made; identify future commitments and resource demands; and identify the key variables that may cause change in the level of revenue.

III. REVENUES

Design, maintain and administer a revenue system that will assure reliable, equitable, diversified and sufficient revenue stream to support desired City services.

A. *Balance and Diversification in Revenue Sources*

The City shall strive to maintain a balanced and diversified revenue system to protect the City from fluctuations in any one source due to changes in local economic conditions, which may adversely impact that source.

B. *User Fees - General Fund*

1. For services that benefit specific users, the City shall establish and collect fees to recover the costs of those services. Where services provide a general public benefit, the City shall recover the costs of those services through property and sales taxes.
2. At a minimum, the City will strive to cover direct costs.
3. User fees should be reviewed, at a minimum, every two to three years and adjusted to avoid sharp changes.
4. Factors in setting fees shall include, but not be limited to: market and competitive pricing, effect of demand for services, and impact on users, which may result in recovering something less than direct, indirect and overhead costs.
5. The City may set a different fee for residents versus non-residents.
6. User fees should be adopted by Council Ordinance and included in the Annual Fee Schedule.

C. *User Fees - Enterprise Funds*

1. Utility rates and other Enterprise Fund user fees shall be set at levels sufficient to cover operating expenditures (direct and indirect), meet debt obligations and debt service coverage, provide pay-as-you-go funding for capital improvements, and provide adequate levels of working capital.
2. The City may set a different fee for residents versus non-residents.
3. The Five-Year Financial Plan (rate model) and proposed operating budget shall serve as the basis for rate change considerations.
4. When necessary, the Five-Year Financial Plan (rate model) will be built around small rate increases annually versus higher rate increases periodically.

D. *One-Time/Unpredictable Revenue Sources*

1. One-time, unpredictable revenue sources should not be used for ongoing expenses/expenditures.
2. One-time, unpredictable revenue sources will be used for one-time purchases such as increase in fund balance requirements, capital equipment purchase, capital improvements, etc.

E. *Revenue Collection*

The City shall maintain high collection rates for all revenues by monitoring monthly receivables. The City shall follow an aggressive, consistent, yet reasonable approach to collecting revenues to the fullest extent allowed by law for all delinquent taxpayers and others overdue in payments to the City.

Revenues actually received will be compared to budgeted revenues by the Director of Finance and any variances considered to be material will be investigated. This process will be summarized in the monthly financial report. (See Financial and Management Reporting.)

F. *Write-Off of Uncollectible Receivables*

(excludes property taxes, court fines and warrant)

1. Receivables shall be considered for write-off as follows:
 - a. State statute authorizing the release of extinguishment, in whole or in part, of any indebtedness, liability, or obligation, if applicable.

- b. Accounts outstanding for 3 years, identified as uncollectible, and all attempts to collect have been taken.
2. Accounts shall be written-off annually near year-end. Upon approval, accounts will be forwarded to a credit reporting agency.
3. The write-off of uncollected accounts is a bookkeeping entry only and does not release the debtor from any debt owed to the City.

IV. EXPENDITURES

Identify services, establish appropriate service levels and administer the expenditure of available resources to assure fiscal stability and the effective and efficient delivery of those services.

A. *Maintenance of Capital Assets*

Within the resources available each fiscal year, the City shall maintain capital assets and infrastructure at sufficient level to protect the City's investment, to minimize future replacement and maintenance costs, and to maintain service levels.

B. *Periodic Program/Services Reviews*

The City Manager and staff shall undertake periodic reviews of City programs and services for both efficiency and effectiveness. Programs or services determined to be inefficient and/or ineffective shall be recommended through the annual budget process to be reduced in scope or eliminated.

C. *Purchasing*

All City purchases of goods and services shall be made in accordance with the City's current Purchasing manual.

V. FUND BALANCE AND RESERVES

Maintain the fund balance and working capital of the various operating funds at levels sufficient to protect the City's credit worthiness as well as its financial position during emergencies or economic fluctuations.

A. *General Fund Unrestricted Fund Balance*

The City shall maintain the General Fund unrestricted fund balance equivalent to 2 months of recurring operating expenditures, based on current year expenditures. If the fund balance exceeds this amount, funding non-recurring expenditures in the following fiscal year may be used to draw down the balance.

B. *Water/Sewer Unreserved Working Capital*

The City shall maintain a working capital sufficient to provide for reserves for emergencies and revenue shortfalls. A cash equivalent operating reserve will be established and maintained at 25% of the current year's budget appropriation for recurring operating expenses.

The cash operating reserve is derived by dividing the total cash equivalents balance by recurring operating expenses.

C. *Use of Fund Balance/Working Capital*

Fund balance/Working Capital shall only be used for emergencies, non-recurring expenditures/ expenses or major capital purchases that cannot be accommodated through current year savings. Should such use reduce balances below the level established as the objective for that fund, restoration recommendations will accompany the request/decision to utilize said balances.

D. *Debt Service Fund Unrestricted Fund Balance*

The City shall maintain the debt service fund balance at 10% of annual debt service requirements OR a fund balance reserve as required by bond ordinances, whichever is greater.

E. *Property/Liability Insurance Fund Unrestricted Fund Balance*

The Property/Liability Insurance Fund accounts for uninsured and deductible claims for the City's property and liability insurance. Claims cannot be reasonably predicted and budgeted for; therefore the fund will maintain a balance that approximates the prior average annual expense for the last three years, excluding extra-ordinary expenses in the fund.

F. *Employee Benefits Fund Unrestricted Fund Balance*

The Employee Benefits Fund is funded through City and employee contributions. Estimated costs shall be determined during each budget year and the contributions adjusted accordingly. There is no minimum balance for this fund.

G. *Economic Development Corporation*

As sales tax revenue fluctuates due to changes in economic conditions, the PEDC shall maintain a fund balance of no less than 10% of budgeted sales tax revenues.

H. *Water/Sewer Revenue Debt Coverage Reserves*

Revenues shall be maintained at 1.15 times coverage in a fiscal year where the water/sewer fund is not issuing additional debt and 1.4 times coverage in a year where debt is anticipated to be issued.

I. *Bond Issuance Reserves*

Debt service reserves should be maintained for each bond issue as required by bond covenants.

J. *Contingency Fund*

Pursuant to the City Charter, a provisions shall be made within the annual budget for a contingency fund in an amount not more than seven percent of the total budget (General Fund) to be used in case of unforeseen items of expenditure.

K. *Fund Balance Classification*

The governmental fund financial statements will present fund balances based on classifications that comprise a hierarchy that is based primarily on the extent to which the City is bound to honor certain constraints on the use of the financial resources within the governmental funds. The classifications used will be as follows:

- **Nonspendable:** Amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. Examples include Inventories, prepaid items, and long-term receivables.
- **Restricted:** Amounts for which constraints have been placed on the use of resources either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation. Restricted fund balances include but may not be limited to: Debt Service Reserves, Special Court Funds created by State Statute, Debt Service Funds, Hotel Occupancy Tax, State and Federal Forfeitures/Seizures, Parkland, Detention, Sidewalk, Tree Trust, and Park and City-Wide Donation revenues, University of Houston Fund, Unspent bond proceeds, Unspent grant funds, Unspent Capital Lease proceeds, and Unspent funds received pursuant to funding, developer, and/or TxDOT agreements.
- **Committed:** Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the City Council. These amounts cannot be used for any other purpose unless the City Council removes or changes the specified use by taking the same type of action that was employed when the funds were initially committed.
- **Assigned:** Amounts that are constrained by the City's intent to be used for specific purposes but are neither restricted nor committed. In governmental funds other than the general fund, assigned fund balances represents the amount that is not restricted or committed. This indicates that those resources are, at a minimum, intended to be used for the purpose of that fund. Examples include: residual funds in all governmental funds except the General Fund and outstanding encumbrances at year-end.
- **Unassigned:** Is the residual classification of the general fund and includes all amounts not contained in other classifications. Unassigned amounts are technically available for any purpose.

Commitment of Fund Balance:

- The City Council is the City's highest level of decision making authority and the formal action that is required to be taken to establish, modify, or rescind a fund balance commitment is an ordinance approved by the City Council at a regular City Council meeting. The ordinance must either be approved or rescinded, as applicable, prior to the last day of the fiscal year for which the commitment is made. The amount subject to the constraint may be determined in a subsequent period.

Assignment Fund Balance:

- The City Council has authorized the Director of Finance as the official authorized to assign fund balance to a specific purpose pursuant to the guidelines.

Order of Expenditure of Funds:

- When multiple categories of fund balance are available for expenditure, the City would typically use Restricted fund balances first, followed by Committed, and then Assigned, but reserves the right to selectively spend from any of the categories, including Unassigned based upon the individual circumstances.

VI.

CAPITAL EXPENDITURES AND IMPROVEMENTS

Annually review and monitor the state of the City's capital equipment and infrastructure, setting priorities for its replacement and renovation based on needs, funding alternatives, and availability of resources.

A. *Capitalization Threshold for Tangible Capital Assets*

1. Tangible capital items should be capitalized only if they have an estimated useful life of 2 years or more following the date of acquisition or significantly extend the useful life of the existing asset and cannot be consumed, unduly altered, or materially reduced in value immediately by use and have a cost of not less than \$5,000 for any individual item.
2. The capitalization threshold of \$5,000 will be applied to individual items rather than to a group of similar items (i.e.: desks, chairs, etc.).
3. To maintain adequate control over non-capitalized tangible items, items costing \$1,000 - \$4,999 will be monitored, tagged, and tracked through the City financial software system.
4. Accurate inventories of all tangible items will be maintained to ensure proper stewardship of public property.

B. *Five-Year Capital Improvement Plan (CIP)*

1. The City shall annually prepare a five-year capital improvement plan based on the needs for capital improvements and equipment, the status of the City infrastructure, replacement and renovation needs, and potential new projects. Capital projects are improvements or additions to the City's physical plant/facilities/infrastructure and become a part of the City's asset inventory. Capital projects can be further categorized into land, buildings, improvements other than buildings, and infrastructure, which includes roads, sidewalks, bridges, utility lines, physical plants, etc. Capital costs typically consist of preliminary design, final design, and construction,

and may involve the acquisition of land or easements. For purposes of the CIP Plan, a Capital Improvement Project should generally exceed a cost of \$100,000.

2. For the most part, projects in the CIP should be based upon master plans or developer agreements. This ensures that the City's CIP, which is the embodiment of the recommendations of these individual planning studies, is responsive to the officially stated direction of the City as contained in the Comprehensive Plan and supporting master plans. Examples of these supporting documents are: Water and Wastewater Modeling Plans, Thoroughfare Plan, Parks Master Plan, Trail Plan, Municipal Facilities Plan, etc.
3. For every project identified in the CIP, a project scope and project justification will be provided. Also, project costs shall be estimated, funding sources identified and annual operation and maintenance costs computed.
4. Parks Board and the Planning and Zoning Commission will be provided opportunities to review the list of CIP projects for the CIP and may suggest additions and/or changes to the plan as appropriate. Pursuant to the City Charter, the Planning and Zoning Commission makes recommendation to the City Manager.
5. The City Manager is charged with recommending a Capital Improvement Plan to City Council. The CIP shall be filed and adopted in conjunction with the annual budget.
6. Annually, through the budget process and at year-end, projects are to be reviewed. For those identified as complete, any remaining funds will close to fund balance. For those projects with identified savings, the project budget will be reduced and the subsequent savings will flow to fund balance. These funds can then be re-appropriated during the next fiscal year capital budget. Funds remaining from bond proceeds will only be used in accordance with the legal use of those funds.
7. Appropriations for capital projects are for the life of the project; therefore re-appropriation of capital funding for each fiscal year for budgeted projects is not necessary.

C. *Infrastructure Evaluation and Replacement/Rehabilitation*

Water, wastewater, drainage, street lighting, streets and sidewalks, municipal facilities and other infrastructure are fundamental and essential functions for public health and safety, environmental protections and the economic well being of the City. As a result, the City's CIP should be focused on ensuring that infrastructure is replaced as necessary to protect the City's investment, to minimize future replacement and maintenance costs, and to maintain existing levels of service and accommodate growth.

1. High priority should be given to replacing/rehabilitating capital improvements prior to the time that they have deteriorated to the point where they are hazardous, incur high maintenance costs, negatively affect property values, or no longer serve their intended purpose.
2. The decision on whether to repair, replace or to rehabilitate an existing capital asset will be based on which alternative is most cost-effective, which would include life-cycle costing, and provides the best value to the City.

D. *Replacement of Capital Assets on a Regular Schedule (Fleet, Fire Trucks, and High-Tech)*

The City shall annually prepare a schedule for the replacement of its fleet, fire trucks, and high technology capital assets. Funding for the replacement of these assets will be accomplished through the annual budget process, within the resources available each fiscal year. A variety of funding options will be explored, including but not limited to cash on hand and lease/purchase, based upon a determination of what would be in the best interest of the City.

E. *Capital Expenditure Financing*

The City recognizes that there are three basic methods of financing its capital requirements: Funding from current revenues; funding from fund balance; or funding through the issuance of debt. Types of debt and guidelines for issuing debt are set forth in the Debt Policy Statements.

F. *Pay-As-You-Go Capital Improvements*

1. The City will pay cash for capital improvements within the financial affordability of each fund versus issuing debt when funding capital improvements and capital purchases. This will reduce/minimize the property tax and utility rate impacts on Pearland citizens.
2. The City will seek out and use intergovernmental funding sources for capital improvements in order to leverage City funding and to minimize property and utility rate impacts.

G. *Capital Improvements/Project Reporting*

A summary/status report on the City's various capital projects will be prepared monthly and available to the City Manager and to City Council. Income statements on the City's CIP funds will be prepared monthly and include budget-to-actual for each project as well as list of major contracts, expense to date, and % contract completion.

VII.
DEBT

Establish guidelines for debt financing that will provide needed facilities, land, capital equipment and infrastructure improvements while minimizing the impact of debt payments on current and future revenues.

A. *Use of Debt Financing*

Debt financing, to include general obligation bonds, revenue bonds, certificates of obligation, certificates of participation, lease/purchase agreements, and other obligations permitted to be issued or incurred under Texas law, shall only be used to purchase capital assets that cannot be prudently acquired from either current revenues or fund balance and to fund infrastructure improvements and additions. Debt will not be used to fund current operating expenditures.

The City will pay cash for capital improvements within the financial affordability of each fund versus issuing debt when funding capital expenditures and capital improvements, which shall include, but not be limited to, sales tax, utility system revenues, developer fees, inter-local agreements, and state and federal grants.

B. *Affordability*

The City shall use an objective analytical approach to determine whether it can afford to issue general-purpose debt, both General Obligation and Certificates of Obligation, water/sewer debt, sales tax revenue debt, and any other financing permitted by State law. The process shall include an internal feasibility analysis for each long-term financing which analyzes the impact on current and future budgets, which would include the tax and utility rates. The process shall also include the benefits of the proposed projects. The decision on whether or not to issue new debt shall be based on the benefits of the project, current conditions of the municipal bond market, and the City's ability to "afford" new debt.

In no case will the City issue general obligation debt that will require a debt service tax rate of \$1.50 per \$100 assessed valuation, based on a 90% collection rate, which is the maximum tax rate permitted by State law.

C. *Types of Long-Term Debt*

1. General Obligation Bonds (GO)

General Obligation bonds require voter approval and are secured by a promise to levy taxes in an amount necessary to pay annual debt service.

a. General Obligation bonds must be issued for projects that are in accordance with the wording in the bond proposition.

2. Certificates of Obligation

Certificates of Obligation may be issued without voter approval to finance any public works project or capital improvement, as permitted by State law. It is the City's policy to utilize Certificates of Obligation to finance public improvements in certain circumstances and only after determining the City's ability to assume additional debt. Circumstances in which Certificates might be issued include, but are not limited to the following.

- a. The City may issue CO's when there is insufficient funding on a general obligation bond-financed capital improvement.
- b. The City may issue CO's when "emergency" (urgent, unanticipated) conditions require a capital improvement to be funded rapidly.
- c. The City may issue CO's for projects when the City can leverage dollars from others to reduce the City's capital cost for a community improvement.
- d. The City may issue CO's for projects when there is no other adequate funding source available (ie: GO or developer funding), the project is determined to be in the best interest of the City, and where a determination is made that waiting for the next bond referendum or having a bond referendum for a small amount of money or a small number of projects is impractical and where public notice versus a voted bond referendum is deemed acceptable by the City Council.
- e. The City may issue CO's if it would be more economical to issue Certificates of Obligation rather than issuing revenue bonds; and
- f. The City may issue CO's for projects for which the City will be reimbursed by Developer (principal plus interest).

3. Revenue Bonds

Revenue bonds are generally payable from a designated source of revenue. They do not require voter approval.

For the City to issue new revenue bonds, revenues, as defined in the ordinance authorizing the revenue bonds in question, shall meet the bond coverage ratio as defined in the ordinance. Annual adjustments to the City's rate structures for Enterprise Funds will be made as necessary to maintain the coverage factor.

If the City should issue CO's for Water/Sewer Improvements, the Water/Sewer Fund will pay the annual debt service associated with the issue.

D. Debt Structures

The City shall normally issue bonds with a life not to exceed 25 years for general obligation bonds and 30 years for revenue bonds, but in no case longer than the useful life of the asset. The City shall seek level or declining debt repayment schedules and shall seek to retire 90% of the total principal outstanding within 20 years of the year of issuance. There should be no debt structures that include increasing debt service levels in subsequent years, with the first and second year of a bond payout schedule the exception or as special situations may warrant. There shall be no "balloon" bond repayment schedules, which consists of low annual payments and one large payment of the balance due at the end of the term. There shall always be at least interest paid in the first fiscal year after a bond sale and principal payments starting generally no later than the second fiscal year after the bond issue. Normally, there shall be no capitalized interest included in the debt structure except for debt issuances reimbursing developers for infrastructure or in the case in which the project will generate revenue, but it takes a couple of years to produce the revenue. Capitalized interest should normally not exceed 2 years.

The City currently has a level debt service structure. As such, unless there is growth (increased valuation, increase in number of connections, etc.) or reallocation of the tax rate to debt service, there is no room for additional debt without increasing rates. The City shall seek to begin making attempts to structure future debt issuances, where affordable, to a declining structure.

The City will issue debt based on a fixed rate and will limit use of variable-rate debt due to the potential volatility of such instruments.

E. *Debt Refunding*

The City's financial advisor shall monitor the municipal bond market for opportunities to obtain interest savings by refunding outstanding debt. As a general rule, the net present value savings of a particular refunding should exceed 3.0% of the refunded maturities unless: (1) a debt restructuring is necessary; or (2) bond covenant revisions are necessary to facilitate the ability to provide services or to issue additional debt or; (3) the refunding is combined with a new debt issuance.

F. *Interest Earnings on Debt Proceeds*

Debt interest earnings will be limited to funding changes to the bond financed Capital Improvement Plan in compliance with the voted propositions, cost overruns on bond projects, or be applied to debt service payments on the bonds issued.

G. *Bond Elections*

1. Timing of general obligation bond elections shall be determined by the inventory of current authorized, unissued bonds remaining to be sold and the Five-Year Capital Improvement Plan.
2. The total dollar amount of bond election propositions recommended to the voters should typically not exceed the City's estimated ability to issue the bonds within a 7-year period.
3. An analysis showing how the new debt combined with current debt impacts the City's tax rate and debt capacity will accompany every future bond issue proposal.

H. *Sale Process*

The City shall use a competitive bidding process in the sale of debt unless the nature of the issue warrants a negotiated sale. The City will utilize a negotiated process when the issue is, or contains, a refinancing that is dependent on market/interest rate timing, if the interest rate environment or market/economic factors may affect the bond issue, or if the nature of the debt is unique and requires particular skills from the underwriters involved. The City shall award the bonds based on a true interest costs (TIC) basis. However, the City may award bonds based on a net interest cost (NIC) basis as long as the financial advisor agrees that the NIC basis can satisfactorily determine the lowest and best bid.

I. *Underwriting Syndicates*

The City's financial advisor shall attempt to involve qualified and experienced firms, which consistently submit ideas to the City and financial advisors and actively participate in the City's competitive sale in its negotiated underwritings. In conjunction with the City, the City's financial advisor shall recommend the structure of underwriting syndicates, which will be optimal for the type and amount of debt being issued.

J. *Bond Ratings*

Full disclosure of operations and open lines of communications shall be maintained with the rating agencies. Credit ratings will be sought from one or more of the nationally recognized municipal bond rating agencies, as recommended by the City's financial advisor.

The City will continually strive to maintain or increase the City's current bond ratings by prudently managing its funds and by reviewing and monitoring financial policies, budgets, forecasts and the financial health of the City.

K. *Covenant Compliance*

The City will comply with all covenants stated in the bond ordinance, including providing for annual disclosure information and providing for material event notices.

L. *Arbitrage Rebate Monitoring and Reporting*

Arbitrage is the interest earned on the investment of bond proceeds above the interest paid on the debt. The City will maintain a system of recordkeeping and reporting to meet the arbitrage rebate compliance requirement of the IRS regulation. The recordkeeping shall include tracking project expenditures, interest earned on the bonds, calculating rebate payments, and remitting any rebatable earnings to the federal government in a timely manner in order to preserve the tax-exempt status of the outstanding debt. Arbitrage rebate calculations will be performed annually on all debt issues and the liability recorded for any positive arbitrage. Due to the specialized nature of the calculations, this function will typically be outsourced.

M. *Lease/Purchase Agreements*

The City will use lease/purchase agreements for the acquisition of equipment when it is cost-effective and provides for attractive terms. All lease purchase agreements will be approved by City Council no matter the dollar amount.

VIII.
CASH MANAGEMENT AND INVESTMENTS

To maintain the City's cash in such a manner so as to ensure the absolute safety of principal, to meet the liquidity needs of the City, and to achieve the highest possible yield.

A. *Investment Management*

1. All aspects of cash/investment management shall be designed to ensure safety and integrity of the City's financial assets.
2. Cash/Investment management activities shall be conducted in full compliance with prevailing local, state, and federal regulations. (See City's Investment Policy and Strategy)
3. The City will utilize competitive quotes from approved broker/dealers, affording no special advantage to any individual or corporate member of the financial or investment community.
4. The City will only do business with City authorized broker/dealers and/or financial institutions as approved by Council and who have executed a written certification of their review of the City's Investment Policy.
5. The City shall design and establish policies relating to a variety of cash/investment management issues, such as the eligibility and selection of various broker/dealers, safekeeping requirements, collateral requirements, delivery versus payment requirements, weighted average maturity requirements and other such aspects of the program, which necessitate standard setting in pursuit of appropriate prudence and enhanced protection of assets.(See City's Investment Policy)
6. Investments of the City shall be made with the exercise of judgment and care which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment.

B. *Investment Strategy*

The City of Pearland maintains a consolidated portfolio in which it pools its funds for investment purposes. The City's investment program seeks to achieve safety of principal, adequate liquidity to meet cash needs, and reasonable yields commensurate with the preservation of principal and liquidity. (See City's Investment Strategy)

C. *Interest Income*

Interest earned from investments shall be distributed to the funds from which the funds were provided.

D. *Arbitrage Investments*

Investment on bond proceeds will be made with safety of principal and liquidity in mind, but with a competitive rate of return. If there is positive arbitrage, the rebatable earnings will be sent to the IRS, as necessary.

E. *Depository*

The City will select its official bank through a formal bidding process in order to provide the City with the most comprehensive, flexible, and cost-effective banking services available. The City will, at a minimum, bid

depository services every five years. The City will review the financial health of the City's depository annually to include but not be limited to earnings, assets, capital, and liquidity.

F. *Collateralization of Deposits*

1. The City shall have pledged collateral held at an independent third-party institution and evidenced by a written receipt.
2. The value of the pledged collateral should be marked to market monthly and shall be at least 102 percent of par or market value of the investments, whichever is greater.
3. Substitutions of collateral shall meet the requirements of the collateral agreement. Collateral shall not be released until the replacement collateral has been received, if the release of the collateral should result in the value being under 102 percent of par value.
4. The pledge of collateral shall comply with the City's investment policy.

IX.

GRANTS AND INTERGOVERNMENTAL REVENUES

The City will seek, apply for, and effectively administer federal, state and local grants, which support the City's current priorities and policy objectives. The City should take advantage of opportunities to enhance service delivery through intergovernmental cooperation, shared revenues, and grants.

A. *Grant Guidelines*

1. The City shall apply and facilitate the application for only those grants that are consistent with the objectives and high priorities identified by Council and management.
2. Grant funding will be considered to leverage City funds. Inconsistent and/or fluctuating grants should not be used to fund ongoing programs and services.
3. The potential for incurring ongoing costs, to include assumptions of support for grant-funded positions from local revenues, will be considered prior to applying for a grant.

B. *Grant Review Process*

1. A uniform grants pre-application process will be utilized to assure the City has all the information necessary to make a decision regarding a potential grant. Information to be provided should include, but not be limited to:
 - a. The grant being pursued and the use to which it would be placed
 - b. The objectives or goals of the City which will be achieved through the use of the grant
 - c. The local match required, if any, plus the source of the local match
 - d. The increased cost to be locally funded upon termination of the grant
2. All grant agreements will be reviewed by the appropriate City staff, including Finance, Legal, HR, and the sponsoring department, to ensure compliance with state, federal, and City regulations.
3. The City Manager shall approve all grant submissions and City Council shall approve all grant acceptances over \$50,000.

C. *Budgeting for Grant Expenditures*

Annually via the budget process, departments will submit for possible funding, known grant opportunities. These grant opportunities will be prioritized and ranked along with all other supplemental requests. If approved, the expenditure and associated revenue will be appropriated in the Grant Fund. If there are grant opportunities that arise during the year and are received by the City, the budget will be amended via the projections, if the City can fund the local match required.

D. *Grant Termination and/or Reduced Grant Funding*

1. In the event of reduced grant funding, City resources will be substituted only after all program priorities and alternatives are considered during the budget process, unless the City is obligated through the terms of the grant to maintain the positions, services, or equipment.
2. The City shall terminate grant-funded programs and associated positions when grant funds are no longer available, and it is determined that the program no longer supports City goals and/or is no longer in the best interest of the City, unless the City has obligated itself through the terms of the grant to maintain the positions, services, or equipment.

X.

FINANCIAL CONSULTANTS

The City will employ qualified financial advisors and consultants as needed in the administration and management of the City's financial function. These areas include but are not limited to audit services, debt administration, delinquent tax collection attorney, and financial modeling. The principal factors in the selection of these consultants will be experience/expertise, ability to perform, the services offered, references, and methodology to name a few. In no case should price be allowed to serve as the sole criterion for the selection.

A. *Selection of Auditors*

At least every seven years, the City shall request proposals from qualified firms, including the current auditors if their past performance has been satisfactory. The City Council shall select an independent firm of certified public accountants to perform an annual audit of the accounts and records, and render an opinion on the financial statements of the City.

It is the City's preference to rotate auditor firms every seven years at the maximum, to ensure that the City's financial statements are reviewed and audited with an objective, impartial, and unbiased point of view. The rotation of the audit firm will be based upon the proposals received, the qualifications of the firm, and the firm's ability to perform a quality audit.

However, if through the proposal and review process, management and the Audit Committee select the current audit firm, then, it is the City's preference that the lead audit partner be rotated, as well as the lead reviewer, after a maximum of seven years.

B. *Arbitrage*

1. The City shall calculate positive/negative arbitrage on each bond issue annually. While the City is responsible to ensure that the records are in order, the calculations made, reporting completed, and filings made, the actual arbitrage calculation and reporting shall be contracted out to a qualified firm.
2. Requests for proposals and statement of qualifications are to be solicited at least every seven years. There is not a requirement for rotation.

C. *Delinquent Tax Collection Attorney*

1. Due to the nature and expertise required, the City shall hire a delinquent tax collection attorney to collect delinquent taxes, represent the City in filing bankruptcy claims, foreclose on real property, seize personal property, and represent the City in court cases and property sales.
2. Requests for proposals and statement of qualifications are to be solicited at least every seven years. There is no requirement for rotation.

D. *Bond Counsel*

1. Bond Counsel to the City has the role of an independent expert who provides an objective legal opinion concerning the issuance and sale of bonds and other debt instruments. As bond counsel are specialized attorneys who have developed necessary expertise in a broad range of practice areas, the City will always use a consultant for these services. Generally, bonds are not marketable without an opinion of nationally recognized bond counsel stating that the bonds are valid and binding obligations stating the sources of payment and security for the bonds and that the bonds are exempt from Federal income taxes.
2. Due to the complexity of the City's financial structure and the benefits that come with the history and knowledge of the City, the contract with Bond Counsel shall be a maximum of ten (10) years, however with a termination clause, at the discretion of the City. A contract may be renewed after a competition process in which the Council determines that continuation with the incumbent firm is in the best interest of the City.

E. *Financial Advisory Services*

1. The City issues various types of securities to finance its capital improvement program. Debt structuring and issuance requires a comprehensive list of services associated with municipal transactions, including but not limited to: method of sale; analysis of market conditions; size and structure of the issue; coordinating rating agency relations; evaluation of and advice on the pricing of securities, assisting with closing and debt management; calculation of debt service schedules; and advising on financial management. As financial advisors to governmental entities have developed the necessary expertise in a broad range of services, the City will use a consultant for these services.
2. Due to the complexity of the City's financial structure and the benefits that come with the history and knowledge of the City, the contract with the Financial Advisor shall be a maximum of ten (10) years, however with a termination clause, at the discretion of the City. A contract may be renewed after a competition process in which the Council determines that continuation with the incumbent firm is in the best interest of the City.

F. *Depository Bank*

Pursuant to State law, the City may approve a depository contract whose term does not exceed five years. There is no requirement for rotation. The City will select its official banking institution through a formal process based on best value in order to provide the City with the most comprehensive, flexible, and cost-effective banking services available.