

Financial & Debt Management Policies

Approved April 19, 2008 and Amended July 22, 2008

Budgeting, Planning & Reserves

Balanced Budget: Arlington County will adopt an annual General Fund budget in which the budgeted revenues and expenditures are equal (a balanced budget). Any one-time revenues will be used for one-time, non-recurring expenses such as capital, equipment, special studies, debt reduction and reserve contributions.

Long-Term Financial Planning: The County will annually develop a six year forecast of General Fund revenues, expenditures and will maintain a biennially updated, six-year Capital Improvement Program (CIP). The six-year forecast will incorporate projected reserve levels and impact of the CIP on the County's debt ratios.

General Fund Operating Reserve: An Operating Reserve will be maintained at no less than three percent of the County's General Fund budget, with a goal of increasing the reserve or reserve-equivalent to five percent of the General Fund budget. The Operating Reserve shall be shown as a designation of total General Fund balance. Appropriations from the Operating Reserve may only be made by a vote of the County Board to meet a critical, unpredictable financial need. A "reserve equivalent" may consist of discretionary funds which have been designated by the County for a non-essential purpose and which the County Board could reallocate for the same purposes as the General Fund Operating Reserve.

Self-Insurance Reserve: The County will also maintain a self-insurance reserve equivalent to approximately one to two months' claim payments based on a five-year rolling average.

General Fund General Contingent: Each year's budget will include a General Fund General Contingent appropriation to be used to cover unforeseen expense items or new projects initiated after a fiscal year has begun. Funding may be allocated from this contingent only with County Board approval.

Retirement System Funding: The County will use an actuarially accepted method of funding its pension system to maintain a fully-funded position. The County's contribution to employee retirement costs will be adjusted annually as necessary to maintain full funding. If the County reaches its actuarial-required contribution (defined as County and employee contributions that when expressed as a percent of annual covered payroll are sufficient to accumulate assets to pay benefits when due), the County may reduce its contribution provided that the amount reduced from the annual actuarial requirement will only be used for one-time, non-recurring expenses in order to provide the ability to increase contributions as may be required by future market conditions.

Other Post-Employment Benefits (OPEB) Funding: The County will use an actuarially accepted method of funding its other post-employment benefits to maintain a fully-funded position. The County's contribution to other post-employment benefit costs will be adjusted annually as necessary to maintain full

funding. If the County reaches its actuarial-required contribution (defined as County and employee contributions that when expressed as a percent of annual covered payroll are sufficient to accumulate assets to pay benefits when due), the County may reduce its contribution provided that the amount reduced from the annual actuarial requirement will only be used for one-time, non-recurring expenses in order to provide the ability to increase contributions as may be required by future market conditions.

Capital Improvement Program

1. The County Manager will biennially submit a six year Capital Improvement Program (CIP) to the County Board. The CIP will address all known facility and infrastructure needs of the County, including the needs of the Arlington County Public Schools.
2. The CIP shall include a detailed description of each capital project, identifying every source of funding, including pay-as-you-go (PAYG), bond financing, and master lease financing. The source of funding will largely be determined based on the useful life of the project. Bond-funded projects will typically have a useful life at least as long as the period over which the bonds will be repaid (generally twenty years). Master lease-financed projects will generally have useful lives of three to ten years and typically include furniture, equipment, rolling stock and technology purchases. PAYG funds provide greater flexibility and will be appropriated annually from general fund revenues.
3. Each project budget shall identify the financial impact on the operating budget, if any.
4. In general, capital projects estimated to cost \$100,000 or more should be included in the CIP, including technology and equipment purchases.
5. The County will balance the use of debt financing sources against the ability to utilize PAYG funding for capital projects. While major capital facility projects will generally be funded through bonds, the County will attempt to maintain an appropriate balance of PAYG vs. debt, particularly in light of the County's debt capacity and analysis of maintenance capital needs. As part of each biennial CIP process, the County will conduct a comprehensive assessment of its maintenance capital needs.
6. The CIP will include an analysis of the impact the CIP has on the County's debt capacity, debt ratios and long-term financial plan.
7. Voter referenda to authorize general obligation bonds should only be presented to voters when the analysis of the County's debt capacity demonstrates the ability of the County to fund the debt service for the bonds based on the County's "Financial and Debt Service Policies." Absent a compelling reason to do otherwise, the County should have the capacity to initiate construction projects within the two-year period before the next bond referendum. There should also be a demonstrated capability for the County to complete any project approved by referendum within the 8-year time period mandated under state law for sale of authorized bonds. The term "County" in this specific policy includes the Arlington County Government and any entity that receives bond funding from the County (such as the Arlington County Public Schools and the Washington Metropolitan Transit Authority).

Debt Management

The County will prudently use debt instruments, including general obligation bonds, revenue bonds, industrial development authority (IDA) revenue bonds, and master lease financing in order to provide re-investment in public infrastructure and to meet other public purposes, including inter-generational tax equity in capital investment. The County will adhere to the following debt affordability criteria (excluding overlapping and self-supporting debt).

1. The ratio of net tax-supported debt service to general expenditures should not exceed ten percent, within the six-year projection.
2. The ratio of net tax-supported debt to full market value should not exceed four percent, within the six-year projection.
3. The ratio of net tax-supported debt to income should not exceed six percent, within the six-year projection.
4. Growth in debt service should be sustainable consistent with the projected growth of revenues. Debt service growth over the six year projection should not exceed the average ten year historical revenue growth.
5. The term and amortization structure of County debt will be based on an analysis of the useful life of the asset(s) being financed and the variability of the supporting revenue stream. The County will attempt to maximize the rapidity of principal repayment where possible. In no case will debt maturity exceed the useful life of the project.
6. The County will refund debt when it is in the best financial interest of the County to do so. When a refunding is undertaken to generate interest rate cost savings, the minimum aggregate present value savings will be three percent of the refunded bond principal amount.

Variable Rate Debt

1. Unhedged variable rate debt exposure should not exceed approximately twenty percent of total outstanding debt. Cash, short-term investments and variable rate debt for which the County has eliminated or reduced variable rate exposure through the use of derivative products may serve as a hedge for variable rate debt and the County may increase variable rate debt over twenty percent accordingly.
2. Debt service on variable rate bonds will be budgeted at a conservative rate.
3. Before issuing variable rate bonds, the County will determine how potential spikes in the debt service will be funded.
4. Before issuing any variable rate bonds, the County will determine the impact of the bonds on the County's total debt capacity under various interest rate scenarios; evaluate the risk inherent in the County's capital structure, giving consideration to both the County's assets and its liabilities; and develop a method for budgeting for debt service.

Derivatives

Interest rate swaps and options (Swaps or Derivatives) are appropriate management tools that can help the County meet important financial objectives. Properly used, these instruments can help the County increase its financial flexibility, provide opportunities for interest rate savings or enhanced investment yields, and help the County reduce its interest rate risk through better matching of assets and liabilities. The County must determine if the use of any Swap is appropriate and warranted given the potential benefit, risks, and objectives of the County.

1. The County may consider the use of a derivative product if it achieves one or more of the following objectives:
 - ❖ Provides a specific benefit not otherwise available;
 - ❖ Produces greater than expected interest rate savings or incremental yield over other market alternatives;
 - ❖ Results in an improved capital structure or better asset/liability matching
2. The County will not use derivative products that are speculative or create extraordinary leverage or risk; lack adequate liquidity; provide insufficient price transparency; or are used as investments.
3. The County will only do business with highly rated counterparties or counterparties whose obligations are supported by highly rated parties.
4. Before utilizing a Swap, the County, its financial advisor and legal counsel shall review the proposed Swap and outline any associated considerations. Such review shall be provided to the Board and include analysis of potential savings and stress testing of the proposed transaction; fixed versus variable rate and swap exposure before and after the proposed transaction; maximum net termination exposure; and legal constraints.
5. Financial transactions using Swaps or other derivative products used in lieu of a fixed rate debt issue should generate greater projected savings than the typical structure used by the County for fixed rate debt.
6. The County will limit the total notional amount of derivatives to an amount not to exceed twenty percent of total outstanding debt.
7. All derivatives transactions will require County Board approval.

Special Revenue / Enterprise Funds

It is the general policy of the County to avoid designation of discretionary funds in order to maintain maximum financial flexibility. The County may, however, create dedicated funding sources when there are compelling reasons based on state law or policy objectives, as described below. The Utilities Fund was created as a self-sustaining, fee-based enterprise fund under state code to support and maintain development of the County's water and sewer infrastructure. The Transportation Investment Fund is proposed pursuant

to state legislation for new transportation funding. The Stormwater Special District Fund is proposed in lieu of a self-supporting, user fee-based enterprise fund.

Utilities Fund

1. The County will annually develop a six year forecast of projected water consumption, revenue, operating expenditures, reserve requirements and capital needs for the Utilities Fund. The six year forecast will show projected water-sewer rate increases over the planning period.
2. The County will implement water-sewer rate increases in a gradual manner, avoiding spike increases whenever possible.
3. The County will meet or exceed all requirements of any financing agreements or trust indentures.
4. The Utilities Fund will maintain a reserve equivalent to three months' operations & maintenance expenses. The reserve may be used to address emergencies and unexpected declines in revenue. If utilized, the reserve will be replenished over a two year period to the minimum reserve level. This reserve is in addition to any financing agreement-required debt service reserve funds.
5. The Utilities Fund will maintain debt service coverage of at least 1.25 times on all debt service obligations.
6. The Utilities Fund will be self-supporting.

Transportation Investment Fund

1. New revenue shall not be used to supplant existing transportation funding commitments, e.g., Metro Matters. Existing commitments are defined as those obligations made prior to adoption of the commercial real estate tax in April 2008.
2. Operating program enhancements (outside base program) that clearly document transportation benefits may be eligible for support from the Transportation Investment Fund
3. No more than 3-5 percent of annual funding should be used for project administration, indirect & overhead costs to support capital projects.
4. A reserve equivalent to ten to twenty percent of annual budgeted revenue will be established.
5. A five to ten year financial plan and model will be developed that integrates project cashflow forecasts, revenue projections, and financial / debt management policies and will factor in other non-County funding sources, including federal, state, regional, and private funding.
6. The County will prudently balance the use of new transportation funding sources between pay-as-you-go funding and leveraging through new bond issuance. Use of leveraging will be dependent on project size, cash flow, and timing projections.
7. If the County chooses to issue debt supported by dedicated transportation funding sources, such debt will be structured to be self-supporting and will not count against the County's general tax supported obligation debt ratios or capacity. Debt service coverage on such debt will range from

1.10 to 1.50 times, depending on the type of debt issued. The term on such bonds will not exceed the average useful life of the assets financed, and amortization will be structured to match the supporting revenue stream.

8. The Transportation Investment Fund will be self-supporting.

Stormwater Fund

1. The County will annually develop a six year projection of stormwater operating and capital expenses.
2. The County will prudently balance the use of new stormwater funding sources between pay-as-you-go funding and leveraging through new bond issuance. Use of leveraging will be dependent on project size, cashflow, and timing projections. If debt is issued for stormwater projects, it will generally follow the debt issuance guidelines contained in this policy.
3. The Stormwater Fund will maintain a reserve equivalent to three months' expenses to be built up over a multi-year period.
4. Stormwater financial policies will be reviewed as part of the Municipal Separate Storm Sewer System (MS4) permit renewal cycle (every five years).
5. The Stormwater Fund will be self-supporting.