SAN BERNARDINO MUNICIPAL WATER DEPARTMENT

POLICIES & PROCEDURES MANUAL

POLICY 10.20 – DEBT MANAGEMENT POLICY

Date:	August 11, 2020
Revision No:	New
Supersedes:	New
First Adopted:	August 11, 2020

POLICY:

The Department may issue debt to finance long-term improvements to its facilities and infrastructure normally included in the Department's Capital Improvement Budget. The primary objective of this Debt Management Policy (Policy) is to establish criteria that will protect the Department's financial integrity while providing a funding mechanism to meet the Department's capital needs.

This Policy establishes guidelines for the issuance and management of the Department's debt. It also provides direction regarding the timing and purposes for which debt may be issued, types and amounts of permissible debt, and method of sale that may be used. Adherence to a debt policy helps to ensure the Department's debt is issued and managed prudently in order to maintain a sound fiscal position and optimal credit ratings.

GOALS:

It is the Department's goal to provide for the infrastructure and capital project needs of its ratepayers, financing those capital project needs from a combination of current revenues, available reserves, and prudently issued debt.

Debt is an equitable means of financing projects and represents an important means of providing for the infrastructure and project needs of the Department's customers. Debt will be used to finance projects if:

- Debt enables the Department to maintain a sound fiscal position;
- Issuing debt will not negatively impact the Department's credit rating;

- It is the most cost-effective means available to the Department; and
- It is fiscally responsible under the prevailing economic conditions.

Annual debt service payments shall be included in the Department's Operating Budget.

DEBT ISSUANCES – GENERAL DEPARTMENT DEBT:

The Department issues general Department debt primarily to fund long-term capital improvement projects, acquisition of land, facilities, infrastructure, water rights and treatment capacity; planning, design and construction of facilities and enlargements or improvements to existing land, facilities, and capacity, essential equipment and vehicle needs (collectively "New Money Debt") and to refinance existing debt ("Refunding Debt"). Debt will be used to finance eligible projects as directed and approved by the Board. The methods of financing, participants of the financing team, and method of sale are summarized below:

METHODS OF FINANCING

The Director of Finance or their designee, will investigate all possible financing alternatives including, but not limited to annual operating revenue, reserves bonds, loans and grants. The Department may legally issue both short- and long-term financing using the debt instruments described below.

1. **Cash Funding** – The Department funds a significant portion of capital improvements on a pay-as-you-go basis. Sources for pay-as-you-go may include appropriations from annual operating revenue, reserves, and grants.

2. **Inter-fund Borrowing** - The Department may borrow internally from other funds with temporarily surplus cash to meet short term needs in lieu of issuing debt. Purposes for such could include short term cash flow imbalances due to grant terms (i.e., the need to incur costs prior to reimbursement) and interim financing pending the issuance of long-term debt. The Department funds from which the money is borrowed shall be repaid with interest, accruing quarterly based upon the apportionment rate set by the State of California Local Agency Investment Fund (LAIF). To the extent any inter-fund borrowing is undertaken in anticipation of long- term financing, the Department shall adopt a Resolution of its intention to repay such funds out of

tax- exempt debt proceeds so as to meet the requirement of federal tax law for such borrowing.

3. **Line of Credit** – The Department may consider a line of credit as a short-term borrowing option. The Director of Finance shall determine when it is prudent to recommend that the Department enter into an agreement with a commercial bank or other financial institution, for the purpose of acquiring a line of letter of credit.

4. **Capital Lease Debt** – A lease purchase obligation placed with a lender without the issuance of securities may be used to finance certain equipment purchases if the aggregate cost of the equipment exceeds $50,000 and the terms of financing are cost-effective. The term of a capital lease must be at least five years and shall not exceed the useful life of the equipment or ten years, whichever is shorter.

5. **State Revolving Fund Loans** - The State Revolving Fund (SRF) is a low or zero interest loan program generally for the construction of water and wastewater infrastructure projects. The SRF loan interest rate is typically calculated by taking half of the True Interest Cost (TIC) of the most recent State of California General Obligation Bonds sale. The repayment term of the loan ranges from 20 to 30 years.

6. **Certificates of Participation** – The Department may issue Certificates of Participation (COP) which provide financing through a lease, installment sale agreement, or contract of indebtedness and typically do not require voter approval. Board action is legally sufficient to authorize a COP issue, and Department revenues are pledged for repayment of COPs under terms specified in the indenture.

7. **JPA Revenue Bonds** – The Department may obtain financing through the issuance of debt under a joint exercise of powers agreement with such debt payable from amounts paid by the Department under a lease, installment sale agreement, or contract of indebtedness.

8. **Refunding Revenue Bonds –** The Department may issue refunding revenue bonds to refund Department indebtedness pursuant to the State of California local agency refunding revenue bond law (Title 5 of the

California Government Code).

ROLES AND RESPONSIBILITY

The primary responsibility for developing debt financing recommendations rests with the Director of Finance. In developing such recommendations, the Director of Finance shall consider the need for debt financing and assess progress on the current capital improvement program (CIP), and any other program/improvement deemed necessary by the Department. The Board authorizes and approves debt financing and/or debt service-related recommendations and proposals. All proposed debt financings shall be presented to and approved by the Board.

BOND COUNSEL

The Department shall retain external bond counsel for all debt issues. As part of its responsibility to oversee and coordinate the marketing of all Department indebtedness, the Director of Finance/General Manager will make recommendations for approval by the Board on the retention of bond counsel.

Bond counsel will prepare the necessary authorizing resolutions, agreements and other documents necessary to execute the financing. All debt issued by the Department will include a written opinion by bond counsel affirming that the Department is authorized to issue the debt, stating that the Department has met all state constitutional and statutory requirements necessary for issuance, and determining the debt's federal income tax status.

FINANCIAL ADVISORS

The Department may utilize the services of independent financial advisors when deemed prudent by the Director of Finance. Services and compensation caps shall be defined by contract. The primary responsibilities of the financial advisor are to advise and assist on bond document negotiations, transaction structuring including advising on call provision options and timing of issuance, running debt service cash flow analysis, assistance in obtaining ratings on the proposed issuance, and generally acting as an independent financial consultant and economic market expert.

The financial advisor will advise the Department on refunding opportunities for current outstanding debt, as well as assist in evaluating the merits of competitive, negotiated or private placement of new debt, and determining the most appropriate structure to ensure effective pricing that meets the Department’s near-term and long term cash flow needs. The financial advisor will work with all parties involved in the financing transaction, including the Department’s bond counsel, trustee, underwriters, credit liquidity providers, to develop and monitor the financing schedule and preparation of the Official Statement.

UNDERWRITERS

For negotiated sales, the Department will generally select or pre-qualify underwriters through a competitive process. This process may include a request for proposal or qualifications to firms considered appropriate for the underwriting of a particular issue or type of bonds. The Director of Finance with the concurrence of the General Manger, will determine the appropriate method to evaluate the underwriter submittals and then select or qualify firms on that basis. The Department will not be bound by the terms and conditions of any underwriting agreements; oral or written, to which it was not a party.

METHOD OF SALE

The Department will select the method of sale, which best fits the type of bonds being sold, market conditions, and the desire to structure bond maturities to enhance the overall performance of the entire debt portfolio. Three general methods exist for the sale of municipal bonds:

1. **Competitive sale.** Bonds will be marketed to a wide audience of investment banking (underwriting) firms. The underwriter is selected based on its best bid for its securities. The Department will award the sale of the competitively sold bonds on a true interest cost (TIC) basis. Pursuant to this policy, the General Manager / Director of Finance is hereby authorized to sign the bid form on behalf of the Department, fixing the interest rates on bonds sold on a competitive basis.

2. **Negotiated sale.** In negotiated sale, the underwriter or underwriting syndicate is selected in accordance with the Departments purchasing policy for professional services. The interest rate and the underwriter’s fee are negotiated prior to the sale, based on market conditions. The underwriter will actively assist the Department in structuring the financing and marketing of bonds including providing assistance in preparing the bond offering circular. This type of sale allows the Department to discuss different financing techniques with the underwriter in advance of the sale date, and

therefore is often appropriate for complex bond structures or credit situations such as Mello-Roos bonds and refundings.

3. **Private placement.** The Department may elect to issue debt on a private placement basis. Such method may be considered if it is demonstrated to result in cost savings or provide other advantages relative to other methods of debt issuance, or if it is determined that access to the public market is unavailable and timing considerations require that a financing be completed.

CAPITAL IMPROVEMENT PLANNING

The Department has developed and maintains a Capital Improvement Program (CIP) spending plan as part the Department’s annual budget process. The Department’s CIP spending plan is a multi-year management tool that identifies public facility and equipment requirements and identifies funding sources that are available to cover the costs of these projects. The Department shall coordinate its debt issuance to ensure that where the CIP spending plan identifies project funding using debt financing, such financing conforms to the CIP plan regarding the level and composition of outstanding debt, the impact on future debt burdens, and current revenue requirements.

DEBT CAPACITY

There is no specific provision within the California Government Code that limits the amount of debt that may be issued by the Department. The Department’s capacity to issue debt is limited by the cash flow requirements of any existing bond indentures and covenants along with the provisions of the Policy in accordance with the Department’s overall financing objectives. Prior to issuance of new debt, the Department shall consider and review its financial condition along with the prevailing market environment to ensure the Department’s credit ratings and financial health remain at levels consistent with the most highly rated comparable public agencies.

STRUCTURE AND TERM

Term of Debt – Debt will be structured for the shortest period possible, consistent with a fair allocation of costs to current and future users. The standard term of long- term debt borrowing is 10 to 30 years. Consistent with its philosophy of keeping capital facilities and infrastructure systems in good condition and maximizing a capital assets useful life, the Department will budget to set aside operating revenue to finance ongoing maintenance and to provide reserves for rehabilitation and replacement. No debt will be issued for periods exceeding the useful life of projects to be financed.

Debt Repayment – In structuring a bond issue, the Department will manage the amortization of the debt and, to the extent possible, match its cash flow to the anticipated debt service payments. In addition, the Department will seek to structure debt with aggregate level debt service payment over the life of the debt.

A non-level debt service structure will be considered if it is beneficial to the Department's overall debt payment schedule, or if such structuring will allow debt service to more closely match project revenues during the early years of a project's operation.

Interest Rate Structure – The Department typically issues long-term debt on a fixed interest rate basis. When appropriate, the Department may choose to issue securities that pay a rate of interest that varies according to a pre-determined formula or results from a periodic remarketing of the securities for the purpose of achieving a lower cost of borrowing or for short-term financing. In determining whether to use variable rate debt or not, the Department will analyze the risk associated with the variable rate debt due to the potential volatility of such instruments. When utilized, the amount of variable rate debt should not exceed 25% of the total outstanding bond indebtedness.

Credit Enhancement - The Department will consider the use of credit enhancement on a case-by-case basis. Types of credit enhancement include letters of credit, bond insurance, and surety policies. Only when clearly demonstrable savings can be realized shall credit enhancement be utilized.

Debt Service Reserve Funds – Debt service reserve funds are held by the Trustee to make principal and interest payments to bondholders in the event that pledged revenues are insufficient to do so. The Department will fund debt service reserve funds when it is in the Department's overall best financial interest.

In lieu of holding a cash funded reserve, the Department may substitute a surety bond or other credit instrument in its place. Additionally, the Department may decide not to utilize a reserve fund if the Department's financing team determines there would be no adverse impact to the Department credit rating or interest rates.

Call Provisions - In general, the Department's securities should include optional call provisions. The Department will avoid the sale of non-callable, long-term fixed rate bonds, absent careful evaluation of the value of the call option.

Debt Limits - There is no specific provision within the California Government Code that limits the amount of debt that may be issued by the Department. The Department's borrowing capability is limited by the additional bonds test and debt coverage ratio required by the existing bond covenants. The Department will be mindful of its overall debt burden in the context of its revenues, expenses, reserves, and overall financial health.

Refunding - Current and advance refunding are important debt management tools for the Department. They are commonly used to achieve debt service (interest cost) savings, remove or change bond covenants, or restructure debt service obligations. Since the Federal Tax law allows only one advance refunding after the initial issuance, careful planning and timing must be used.

To the extent that debt having fixed interest rates originally structured with a long- term amortization structure (ten years or greater) is refunded with fixed rate debt, the Department will not generally issue refunding debt which extends beyond the final maturity of the refinanced debt. Extending the final maturity may occur when warranted, such as restructuring of debt to match debt amortization with the useful life of the financed assets.

CREDITWORTHINESS OBJECTIVES

Ratings reflect the fiscal soundness of the Department and the capabilities of its management. Typically, the higher the credit ratings are, the lower the interest cost on the Department's debt issues. To enhance creditworthiness, the Department is committed to prudent financial management, systematic capital planning, and long-term financial planning. The Department recognizes that external economic, natural, and other events may affect the creditworthiness of its debt.

POST ISSUANCE ADMINISTRATION / INTERNAL CONTROL

Investment of Proceeds - The Department shall comply with all applicable Federal, State, and contractual restrictions regarding the use and investment of bond proceeds, including the Department's Investment Policy. This includes compliance with restrictions on the types of investment securities allowed, restrictions on the allowable yield of some invested funds, as well as restrictions on the period during which bond proceeds may be invested. The Department will comply with all terms and conditions of the appropriate bond documents related to each debt transaction and seek to maximize investment earnings within the parameters set forth therein.

Use of Proceeds - Bond proceeds will be deposited and recorded in separate accounts to ensure funds are not comingled with other Department funds. The Department's Trustee will administer the disbursement of bond proceeds pursuant to each certain Indenture of Trust or Fiscal Agent Agreement, respectively. To ensure proceeds from bond sales are used in accordance with legal and tax requirements, invoices are submitted by the Engineering Division and approved by the Director of Finance and General Manager for payment. Requisition for the disbursement of bond funds will be approved by the Director of Finance.

The Finance Division will be tasked with monitoring the expenditure of bond proceeds to ensure they are used only for the purpose and authority for which the bonds were issued and exercising best efforts to spend bond proceeds in such a manner that the Department will meet one of the spend-down exemptions from arbitrage rebate. Tax-exempt bonds will not be issued unless it can be demonstrated that 85% of the proceeds can reasonably be expected to be expended within the three-year temporary period.

Arbitrage Compliance - The Department shall minimize the cost of arbitrage rebate and yield restrictions while strictly complying with applicable tax law. Because of the complexity of arbitrage rebate regulations and the severity of non-compliance penalties, the Department shall solicit the advice of bond counsel and other qualified experts about arbitrage rebate calculations. The Department shall contract with a qualified third-party for preparation of the arbitrage rebate calculation.

Compliance with Bond Covenants – The Department is responsible for verifying compliance with all undertakings, covenants, and agreements of each debt issue on an ongoing basis. This typically includes ensuring:

- Annual appropriations of revenues to meet debt service payments
- Timely transfer of debt service payments to the Trustee
- Compliance with insurance requirements
- Compliance with rate covenants

The Department shall comply with all covenants and conditions contained in the governing law and any legal documents entered into at the time of the bond offering or signing of agreements. The Director of Finance or designee will coordinate verification and monitoring of covenant compliance.

Rating Agency Communication - The Director of Finance shall be responsible for maintaining the Department's relationships with Standard & Poor's Ratings Services, Fitch Ratings and/or Moody's Investment Service. In addition to general communication, the Director of Finance shall meet with credit analysts prior to each competitive sale and offer conference calls with the Department financing team in connection with the planned sale.

Board Communication - The Director of Finance will report to the Water Board any feedback from rating agencies and/or investors regarding the Department's financial strengths and weaknesses and recommendations for addressing any weaknesses.

Continuing Disclosure - The Department shall remain in compliance with Rule 15c2-12 by filing its annual financial statements and other financial and operating data for the benefit of its bondholders by December 31st. of each year. The Director of Finance will ensure the Department's timely filing with each Nationally Recognized Municipal Securities Information Repository.

Record Retention - A copy of all debt-related records shall be retained at the Department's offices. At minimum, these records shall include all official statements, bid documents, bond documents / transcripts, resolutions, trustee statements, leases, and title reports for each Department financing (to the extent available). Electronic copies - preferably in pdf format shall also be retained.

SB 1029 COMPLIANCE

SB 1029, signed by Governor Brown on September 12, 2016, requires issuers to adopt debt policies addressing each of the five items below. The Department believes this Policy is in compliance with SB 1029:

1. The purposes for which the debt proceeds may be used.

2. The types of debt that may be issued.

3. The relationship of the debt to, and integration with, the issuer’s capital improvement program or budget, if applicable.

4. Policy goals related to the issuer’s planning goals and

objections.

5. The internal control procedures that the issuer has implemented, or will implement, to ensure that the proceeds of the proposed debt issuance will be directed to the intended use.

BOARD DISCRETION

The Policy was drafted with the intent of providing San Bernardino Municipal Water Department's Board-approved guiding directives to management and staff for decisions and recommendations related to the financial profile of the Department and is intended to support the Department's debt obligations to present and future generations of customers. The Policy is intended to be revisited and updated periodically if there is a material change in the risk exposures or conditions.

The Policy is ultimately intended to serve as a guide and it in no way restricts the ability of the Water Board to review proposed rate actions, debt issuances, or other actions of substance to the Department. The Board maintains authorization to waive elements of the policy in connection with individual financings at its discretion.

Policy Review

Board Approved:	8/11/2020
No Changes:	7/2021