Monterey One Water Budget
Debt Management Policy

KEY FACTS

Board Approves Policy

General Manager Works With Board on Bonds

CFO Manages Debt Issuances

Since the Agency does not collect property taxes, it is not subject to a legal debt limit, but is subject to debt coverage minimums

Purpose

The purpose of this Debt Management Policy (the "Policy") is to establish debt management objectives for the effective governance, management, and administration of debt. This Policy is intended to improve the quality of decisions, articulate policy goals, provide guidelines for the structure of debt issuance, and demonstrate a commitment to long-term capital and financial planning. It also provides guidance in regards to the type of debt that may be issued, types and amounts of permissible debt, and the method of sale that may be used.

Adherence to a debt management policy communicates to rating agencies and the capital markets that an organization is well managed and should meet its obligations in a timely manner. Debt financing shall be used for capital expenditures when the project's useful life meets or exceeds the financing term, and dedicated revenues are adequate to pay debt service. M1W shall use proceeds of debt issues in a manner that is consistent with the then applicable City ordinances and Federal tax laws with respect to such debt. Whenever feasible, M1W will use tax-exempt debt. Tax-exempt private activity bonds (which are usually subject to alternative minimum tax) shall be used for qualified exempt facility private activity projects. Federally taxable bonds shall be used for other authorized uses that are not otherwise permitted to be financed with tax-exempt bonds. This Policy has been developed based on the Government Finance Officers Association Best Practices – Debt Management Policy; and in accordance with California Government Code Sections 8855(i) and (k), effective January 1, 2017.

Authority and Responsibility

- **Board of Directors**

The Board of Directors approves the Policy, any revisions and all debt Issuances.

- **General Manager**

The General Manager reviews the Policy and debt issuances prior to Board approval.

- **Chief Financial Officer**

The Chief Financial Officer of the Agency (the "CFO") is responsible for managing and coordinating all activities related to the structure, issuance, reporting, communicating and administration of long-term debt obligations. This includes contracting for professional services to assist in maintaining legal requirements and minimizing debt costs.

Legal Uses of Debt / Financial Requirements

The Agency reports its activities as Enterprise funds and is not subject to California Government Code Section 43605 relating to property value assessments. Debt issuances of the Agency may be restricted by existing debt covenants.

DEBT AUTHORIZED & ISSUED

Revenue Bonds (2012 & 2013 Bonds)

Equipment Leases (For 2 cars)

Federal and State Loans (2017 SRF Loan)

Lines of Credit (LOC with Bank of the West for PWM Project)

Legal Uses of Debt / Financial Requirements (Continued)

The Agency will consider financing for the acquisition, refurbishment, replacement or expansion of physical assets, including land improvements. Long-term debt financing will not be used to fund operating or maintenance costs; or projects or assets with a useful life that exceed the debt repayment period. Debt is for financing the following items:

1. Acquisition of a capital asset with a minimum useful life equal to term of debt service
2. Construction or reconstruction of a facility
3. Acquisition of land, right of way, or long-term easements
4. Refinancing or advance funding of pension obligations that provides financial benefit
5. Interim cash flow financing, such as a line of credit for the Agency's capital program

Approved Debt Instruments

The Agency shall not assume additional debt without conducting an objective analysis of the Agency's ability to assume and support additional debt service payments. Unless specific compelling reasons exist, there shall be no "balloon" bond repayment schedules, including those involving capital appreciation bonds, which consist of low annual payments and one large payment due at the end. Types of debt authorized under this policy include:

Revenue Bonds, including Revenue and Bond Anticipation Notes
Payment for revenue bonds are secured by user fees. Revenue anticipation notes (TRANS) are one-year, interest-bearing notes that are issued to manage cash flow variability. BANs are short-term bonds issued in the anticipation of long-term future bond issuances.

Certificates of Participation or Lease Revenue Bonds
These types of debt are issued for capital improvements or land acquisition. It is typical for the asset being acquired to act as the security for the debt service payments on the certificates; however the Agency is ultimately liable for all debt service.

Federal and State Government Loans (including State Revolving Funds (SRF))
Government loans provide funds for capital financing at a low interest rate.

Lines of Credit / Refunding Bonds
A line of credit provides readily accessible funds to assist with cash flow. The Agency would typically use a line of credit to support projects that are funded by reimbursable grants, loans, or through Board-approved third party agreements. Refunding bonds can be issued to replace and refinance outstanding revenue bond obligations at lower interest rates..

Loans, including Equipment Lease Financing
In the event the Agency chooses to proceed with a direct loan or private placement for of debt, The Agency may award solely based upon true-interest cost but may take into consideration call features, debt service structure, and the requirement of reserve funds.

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Minimum Debt Coverage Ratio 125%

Board Preferred Coverage Ratio of at least 170%

Fixed Rate Debt is Preferred

Goal that not more than 50% of CIP be financed by debt

Maturity should not exceed life of assets

Use of Derivatives Prohibited

The use of certain derivative products to hedge variable rate debt, such as interest rate swaps, is not allowed unless approved by the Board. A comprehensive derivative policy will be adopted by the Agency prior to issuance of such debt.

Integration of Debt and Capital Improvement Budget / Legal Debt Limits

The CFO is responsible for developing and maintaining a multi-year rate model, which takes into consideration operating revenues and expenses; the capital improvement program; and debt covenant and reserve requirements. This model is used to develop rates sufficient to cover anticipated costs, as well as evaluate "pay as you go" or debt financing strategies to fund capital improvements. The Agency has identified an ideal debt coverage ratio of 170%, with a minimum debt service coverage ratio of 125% as required under its bond convenants. The Agency has no other legal debt limits as it does not issue general obligation debt and relies strictly on its fees for revenues. Not more than 55% of the overall CIP should be financed with debt. With respect to debt repayment and amortization, the debt repayment period should be structured so that the weighted average maturity of the debt does not exceed 100% of the expected average useful life of the project being financed. The PWM net available budget shall provide for a minimum of 110% debt service coverage to meet State Revolving Fund (SRF) loan requirements.

Debt Management Practices

Term and Repayment / Redemption Features

The Agency will structure its debt issues so that the maturity of the debt is no greater than the economic or useful life of the capital project to be financed. Whenever possible and to save on interest costs, the Agency should consider shorter-term borrowings where appropriate. Typically, the Agency desires level debt service payments over the term of the debt. The cost of capital, financial risk, current economic conditions, future financial flexibility, credit rating, and available cash flow will be evaluated to determining the most appropriate method of debt amortization for the issue. Redemption provisions and call features shall be evaluated in the context of each bond sale to enhance marketability of bonds; ensure flexibility of related to potential early redemption; and to foster refunding transactions. The potential for additional costs such as a call premium and higher interest rates will be evaluated in the decision to redeem bonds.

Fixed and Variable Rate Debt

The Agency's practice is to issue fixed rate debt. Such debt provides absolute certainty, at the time of the bond sale, as to the level of principal and interest owed annually. Specific conditions may arise where the Agency would consider variable interest bonds; however significant consideration should be given to the interest rate risk over the term of the financing. For variable rate debt, the variable rate may be based on one of a number of commonly used interest rate indices. Applicable issuances may include, but are not limited to, public marketed indexed notes. Prior to the issuance of variable rate debt, the savings and other possible advantages compared to borrowing at a fixed rate and will be subject to evaluation and comparative analysis.

TYPES OF BOND SALES

Competitive- Awarded based upon lowest borrowing cost resulting from competitive bids

Negotiated- Used for bonds that are complex and that require additional marketing

Private – Not sold to the General Investor Community

Refunding – Issued when there are net Net Present Value (NPV) Savings of at least 3%

Debt Management Practices (Continued)

Credit Enhancement

A credit enhancement may be used to improve a credit rating on an Agency debt obligation. Types of credit enhancements include bond insurance, surety policies, or letters of credit. The CFO will consider the use of a credit enhancement if it reduces the overall cost of a proposed financing or the credit enhancement furthers the Agency. M1W's goal is to maintain investment grade credit ratings of A- or greater. Non-rated financing may be used whenever it is cost-effective.

Method of Sale

In the event of an issuance of bonds or certificates of participation by the Agency, the CFO will select the method of sale that best fits the type of bonds being sold, the prevailing market conditions, and the desire to structure bond maturities to enhance the performance of the entire debt portfolio. The following methods can be used for the issuance of bonds:

- **Competitive Sale** – Bids for the purchase of bonds are opened at a specified place and time and are awarded to the underwriter or syndicate whose confirming bid represents the lowest true interest cost to the Agency.
- **Negotiated Sale** – The Agency selects the initial buyer of the bonds in advance of the sale date. The initial buyer is usually an investment banking firm, or a syndicate of investment banking firms interested in reoffering the bonds to investors through an underwriting process. This type of sale allows the Agency to discuss different financing techniques with the underwriter in advance of the sale date and is particularly appropriate for complex or unique bonds that may require education and marketing to the investment community.
- **Private placement** – This method involves selling the Agency's bonds to a limited number of sophisticated investors. Bonds are not sold to the general investors. Agency staff will perform due diligence in comparing interest costs and fees in private placement to those using a competitive or negotiated sale. The Agency may use a placement agent to assist in identifying investors.
- **Refunding criteria** – Periodic reviews of outstanding debt will be undertaken to identify refunding opportunities. Refunding will be considered if and when there is a net economic benefit of refunding. Refundings which are non-economic may be undertaken to achieve City objectives relating to changes in covenants, call provisions, operational flexibility, issuer, or debt service profile.

In general, refundings which produce a net present value (NPV) savings of at least three percent (3%) of the refunded debt will be considered economically viable. The NPV assessment shall factor in all costs, including issuance, escrow, and foregone interest earning of any contributed funds on hand. Any potential refinancing shall additionally consider whether an alternative refinancing opportunity with higher savings is reasonably expected in the future. Refundings with a negative savings will not be considered unless there is a compelling public policy objective that is accomplished by retiring the debt.

KEY FACTS

Investment of bond proceeds governed by debt covenants and investment policy

Finance Department responsible to maintain records including those related to arbitrage

Accounting Supervisor works with third party firm to prepare annual required disclosures

Debt Management Practices (Continued)

Investment of Bond Proceeds

The proceeds of bond sales will be invested until used for the intended project in order to maximize utilization of public funds. The investments will be made to obtain the highest level of safety and will be guided by the Agency's Investment Policy and bond indenture guidelines.

Internal Control Procedures Related to Intended Use

The Agency references the following internal controls to ensure all bond proceeds are expended for their intended use a.) Review approved use of bond proceeds with department representatives who are authorized to initiate contracts and expend funds to ensure expenditures are consistent with the terms of the bond sale b.) Educate staff responsible for preparing purchase orders and processing payments as to items that are can be expended using bond proceeds, as well as the proper account coding and c.) Require the CFO to review draw-down requests.

Debt Record Keeping

The Finance Department is responsible for maintaining all necessary documentation for the term of each bond issue. With respect to tax-exempt bonds, records should be generally retained for three years following the final maturity of the bonds. All general ledger records, debt payment information, and purchasing order data are maintained in the Agency's financial software system.

Primary and Secondary Market Disclosures

The Accounting Supervisor is responsible for providing annual disclosure information to established national information repositories for maintaining compliance with disclosure requirements by state and national regulatory bodies. This includes providing ongoing disclosure information to the Municipal Securities Rulemaking Board's (MSRB's) Electronic Municipal Market Access system. Disclosures shall include the Comprehensive Annual Financial Report ("CAFR"), enumerated events defined by regulation or bond covenants; and any other information required by the bond indenture or regulatory body. The CFO may also employ the services of a firm to assist with financial disclosure requirements. A minimum of ten years of annual budgets and CAFRs are placed on the Agency's websites.

Arbitrage Rebate Monitoring and Filing

Arbitrage is the interest earned on the investment of bond proceeds above the interest paid on the debt. If arbitrage occurs, the Agency will pay the amount of arbitrage to the Federal Government as required by Internal Revenue Service Regulation 1.148-11. The Agency will maintain a system of record keeping and reporting to meet the arbitrage rebate compliance requirements as designated by the Federal tax code. This effort shall include tracking investment earnings on bond proceeds, calculating rebate payments in compliance with tax law, and remitting any rebate earnings to the federal government in a timely manner. These activities are defined to preserve the Agency's tax-exempt status of the Agency's outstanding debt issuances.

DEBT ISSUANCE TEAM

Financial Advisor – Coordinates Issuance, Evaluates Underwriter Proposals, Manages Bid Process, Develops Outreach, Evaluates Market

Bond Counsel – Reviews Legal Issues, Provides Legal Opinion, Prepares Official Statement

Disclosure Counsel – Prepares disclosure documents

Debt Management Practices (Continued)

Federal and State Law and Bond Convenant Compliance

The CFO is responsible for maintain compliance with disclosure standards promulgated by state and national regulatory bodies. The main disclosure requirements are described in a subsequent section of this policy. In addition to financial disclosure and arbitrage compliance, the Agency is responsible for verifying compliance with all activities, agreements, and requirements outlined in the bond documents on an ongoing basis. This typically includes: Ensuring an annual appropriation to meet debt service payments; relevant fees are levied and collected at a level sufficient to meet indenture requirements and debt service payments; the timely payment of debt service to a trustee or paying agent; and compliance with insurance, reserve, and other mandates.

Debt Issuance Team

The CFO shall be responsible for the solicitation and selection of financial professional services that are necessary to issue and manage debt. The main functions of the debt issuance team are listed below:

Financial Advisor

1. Coordinates the financing and debt issuance process
2. Helps evaluate underwriter proposals, provides financial recommendations
3. Assists with the securing of other professional services needed
4. Monitors and evaluates market conditions for opportunities to issue debt
5. Develops investor outreach and approach
6. Manages competitive bid process
7. Assist the Agency in presenting to bond rating organizations and credit enhancement providers on the M1W's financial condition and the bonds
8. Provide post-issuance advice for bond covenant compliance, when requested

Bond Counsel

1. Provides legal advice, delivers an approving legal opinion related to tax law
2. Prepare and review documents necessary to issue the debt
3. Coordinates the authorization and execution of closing documents
4. Review legal issues relating to the structure of the bond issue
5. Prepare election proceedings or pursue validation proceedings if necessary
6. Review or prepare those sections of the official statement that relate to the Bonds, financing documents, bond counsel opinion, and tax exemption
7. Review or prepare the Notice of Sale or Bond Purchase Contract for the debt and review or draft the continuing disclosure undertaking of M1W
8. Provide Post-issuance advice for bond covenant compliance, when requested

Disclosure Counsel

1. Prepare the disclosure documents (both preliminary and final).
2. Provide Post-issuance advice for bond covenant compliance

DEBT ISSUANCE TEAM (CONT.)

Underwriter
Provides M1W with market information, Assists with Credit Analysis, Oversees Premarketing, Pricing, Sales Trading of Bonds

Trustee –
Holds Funds Related to Bonds and Refunding, Maintains List of Owners, Ensures Compliance With Bond Covenants, Acts as Paying Agent on Bonds

Debt Issuance Team (Continued)

Underwriter

1. Provide M1W with market knowledge
2. Assist with credit analysis and preparation
3. Oversee premarketing, pricing, sales and trading of the Bonds

Trustee/Fiscal Agent/Paying Agent

1. Establishes and holds the funds and accounts relating to the bond issue
2. Maintains the list of all registered owners of the bonds
3. Acts as the authenticating agent and the paying agent
4. Protects the interests of the bondholders by monitoring compliance with covenants and acts on behalf of the bondholders in the event of default
5. As the escrow agent in the event of a refunding, holds the investments acquired with the proceeds of an advance refunding and uses those funds for payments on those investments to pay debt service on the refunding bonds

Debt Disclosure Policies and Procedures

The CFO shall be the disclosure coordinator of the Agency (the "Disclosure Coordinator"). M1W, working with its bond counsel and debt disclosure third party consultant, will file any annual disclosure reports reports required by its bond covenants, the California Debt and Investment Advisory Commission (CDIAC) and with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA"), including its annual Comprehensive Annual Financial Reports. M1W will comply with all applicable U.S. Internal Revenue Service and U.S. Treasury arbitrage requirements for tax-exempt indebtedness in order to preserve the tax-exempt status of such debt.

Official Statements

The Disclosure Coordinator of M1W shall review any Official Statement prepared in connection with any debt issuance by M1W in order to ensure there are no misstatements or omissions of material information in any sections that contain descriptions of information prepared by M1W. In addition, the Disclosure Coordinator shall submit all Official Statements to the M1W Board for approval. The approval of an Official Statement by the Board shall be docketed as a new business matter and shall not be approved as a consent item.

Continuing Disclosure Filings and Training

M1W is also required under its continuing disclosure undertakings to file notices of certain enumerated events with EMMA. The Agency's Accounting Supervisor and Accountant are responsible for establishing a system by which M1W will make the annual filings required by its continuing disclosure undertakings on a complete and timely basis, and the Agency will file notices of enumerated events on a timely basis. The Disclosure Coordinator shall ensure that the members of M1W staff involved in the initial or continuing disclosure process and the Board are trained to understand and perform their duties.